# Notes on Contract Drafting

Getting sensible terms to signature sooner

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*I'm a lawyer but this doesn't make me* your *lawyer.*


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A work in progress.

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## 1.1 About this book

*A work in progress:* This book is still a work in progress; I'm "freezing" this draft for the semester so that people can print it out if they wish.

*Printing:* For many students, this book will work just fine if read on the screen. By student request, however, I've tried to set up the manual for printing to hard copy. Typographically, the setup is less than optimal for printing — for example, there are some page breaks immediately after a heading, instead of keeping the heading together on the same page with the following text. *(It's not* supposed *to do that, but I haven't figured out why it does, nor how to fix it.)*

The arrangement of chapters in this book is somewhat pedagogical: It's in roughtly the order in which I tackle the subjects in a three-semester-hour law school course for students already familiar with basic contract law.

## 1.2 Simulation course: Hypothetical facts

This book is used for a simulation course in contract drafting.

**MathWhiz:** Many of the exercises and discussion questions in this book are set in the context of a hypothetical client relationship in which the reader represents the fictional "MathWhiz LLC" in Houston.

MathWhiz is headed by its founder and CEO "Mary Marvel," who is an expert in analyzing seismic data to predict where oil or natural gas deposits might be. Mary "came up" in the industry working for major oil companies, then started her own company. Her business has grown; she now employs several junior analysts, and also selectively subcontracts work to others (usually, longtime friends or colleagues of hers) to do specialized tasks.

**Gigunda:** One of MathWhiz's clients is (the equally-hypothetical) "Gigunda Energy," a global oil-and-gas company headquartered in California but with a significant campus in Houston. Gigunda Energy expects to collect seismic data, over a period of about a year, from a potential oil field in Outer Mongolia. Gigunda wants to hire MathWhiz to analyze the seismic data.

## 1.3 Semester reading assignments

**The reading load is heavier in the early part of the semester**, to help students get themselves to a baseline level of contract-drafting knowledge; the reading load then eases up — somewhat ….

**Note:** Be sure to read:

- the commentary of the listed Tango Terms provisions; and
- any exercises and/or discussion questions in each chapter, because we'll likely discuss some of them in class.

### Wed. Jan. 20: Basics

I'll be talking through the following materials in the first class session; if you have time before then, feel free to look over these materials — including the discussion questions — but **definitely** read them yourself, soon.

- Syllabus
- Chapter 1: Introduction & semester plan
- Chapter 2: What can "a contract" look like?

### Mon. Jan 25: More basics

#### *Setting up the contract framework*

- Chapter 3: Setting up the contract framework
- Chapter 4: Defined terms
- Chapter 5: Exhibits, schedules, etc.
- Tango Clause 22.143 - Signatures
- Tango Clause 22.131 - Redlining: if you don't want to have to re-read the entire final draft before signing (also a "jerk detector" clause)

#### *Street smarts*

- Chapter 6: Street smarts: Your career
- Chapter 7: Street smarts: Client happiness

#### *Ambiguity*

- Chapter 8: Ambiguity and its dangers

### Wed. Jan. 27: Writing tips

- Chapter 9: General writing rules
- Chapter 10: Interlude: Microsoft Word (focus on items 1-5)

### Mon. Feb. 01: Payments

Skim the following except as otherwise indicated:

- Tango Clause 22.48 - Deposits
- Tango Clause 22.61 - Expense Reimbursement: note the part about payers' expense-reimbursement policies
- Tango Clause 22.88 - Invoicing: note the part about late invoices
- Tango Clause 22.120 - Payment Terms: note especialy the "net X days" discussion
- Tango Clause 22.119 - Payment Security
- Tango Clause 22.151 - Tax Responsibility
- Tango Clause 22.160 - Usury Savings: important; see also § 21.6: interest charges notes
- Tango Clause 22.74 - Guaranties

### Wed. Feb. 03: Relationship; efforts; general

#### *Relationship management*

- Tango Clause 22.147 - Status Conferences: note the reason for agreeing to this
- Tango Clause 22.51 - Disparagement Prohibition: note the possible reasons *not* to ask for this

#### *Efforts clauses*

The definitions in the following clauses are **not** official; they can be included in contracts precisely because the law might not have uniformly-agreed definitions. (W.I.D.D. — When In Doubt, Define!)

- Tango Clause 22.20 - Best Efforts Definition
- Tango Clause 22.32 - Commercially Reasonable Efforts Definition
- Tango Clause 22.127 - Reasonable Efforts Definition
- Tango Clause 22.69 - Good Faith Definition

### *Selected general provisions (1)*

Just skim the following except as otherwise indicated:

- Tango Clause 22.55 - Entire Agreement: note that this *won't* necessarily rule out claims for misrepresentation; review Tango Clause 22.133 - Reliance Waiver
- Tango Clause 22.58 - Evergreen Extensions: note the state-law regulations that might apply
- Tango Clause 22.79 - Independent Contractors: note especially that just saying "independent contractors!" won't make it so
- Tango Clause 22.112 - Notices: **read carefully**
- Tango Clause 22.131 - Redlining: if you don't want to have to reread the entire final draft before your client signs (to be sure the other side didn't slip in any surreptitous changes)
- Tango Clause 22.154 - Third-Party Beneficiary Disclaimer: this is a roadblock clause

## Mon. Feb. 08: Drafting tips; litigation prep

- Chapter 11: Drafting tips
- Chapter 12: Litigation planning
- Tango Clause 22.1 - Acknowledgement Effect

## Mon. Feb. 15: Reps and warranties (in general)

- Tango Clause 22.134 - Representation Definition
- Tango Clause 22.163 - Warranty Definition
- Chapter 13: Representations and warranties
- Tango Clause 22.164 - Warranty Disclaimer General Terms
- Tango Clause 22.133 - Reliance Waiver: this ties in with (and might be a necessary supplement to) Tango Clause 22.55 - Entire Agreement

## Mon. Feb. 22: People

Skim the following to get a sense of the subjects *except* as otherwise indicated

- Tango Clause 22.12 - Associated Individual Definition
- Tango Clause 22.122 - Personnel Qualifications

- Tango Clause 22.18 - Background Checks: carefully read this, with special attention to consent requirements for background checks:
- Tango Clause 22.121 - Performance Improvement Plan Protocol
- Tango Clause 22.80 - Individual Liability Protection
- Tango Clause 22.90 - Knowledge Definition
- Tango Clause 22.158 - Training General-Provisions
- Tango Clause 22.33 - Computer System Access
- Tango Clause 22.144 - Site Visits

### Mon. Mar. 01: Sales

Skim the following to get a sense of the subjects *except* as otherwise indicated

- Tango Clause 22.115 - Order Submission
- Tango Clause 22.113 - Order Fulfillment
- Tango Clause 22.114 - Order fulfillment: Optional clauses
- Tango Clause 22.132 - Referrals
- Tango Clause 22.17 - Audits: relevant to referral deals; also § 21.4, Hollywood accounting: relevant to referral deals
- Tango Clause 22.135 - Resale; also § 21.11: price fixing — antitrust issues abound here
- Tango Clause 20 - Most-favored customer: concerns mainly pricing
- Tango Clause 22.123 - Pricing adjustment options
- Tango Clause 22.36 - Consumer Price Index / CPI Definition
- Tango Clause 22.139 - Services: note especially the parts about licenses and permits
- Chapter 14: Export controls, export controls: Help your clients stay out of prison
- Chapter 15: Foreign Corrupt Practices Act: ditto
- Tango Clause 22.31 - Code of Conduct Limitation: complying with customers' various codes of conduct can be a pain for suppliers

### Mon. Mar. 08: Getting to signature sooner

- Chapter 16: Getting to signature quickly

## Mon. Mar. 22: Indemnity & defense

- Tango Clause 22.78 - Indemnities Protocol
- Tango Clause 22.75 - Hold Harmless Definition
- Tango Clause 22.46 - Defense of Third-Party Claims

## Mon. Mar. 29: Confidentiality and privacy

Skim the following except as otherwise indicated:

- Tango Clause 22.34 - Confidential Information: be sure to read carefully the parts about:
    - two-way vs. one-way confidentiality provisions
    - whether or not to require a receiving party to return or destroy a disclosing party's confidential information
    - a receiving party's motivation to retain archive copies per Tango Clause 22.8 - Archive Copies
- Tango Clause 22.25 - Business Associate Addendum: this is of interest mainly when personal health information is involved
- Tango Clause 22.40 - Data Privacy Customer Obligations
- Tango Clause 22.41 - Data Use Authorization

## Mon. Apr. 05: Termination; noncompetes

### *Termination*

- Tango Clause 22.152 - Termination
- Tango Clause 22.102 - Material & Material Breach Definition
- Tango Clause 22.153 - Termination Wrap-Up: providing an off-ramp for gradual wind-down of, e.g., a reseller- or referral relationship
- Tango Clause 22.150 - Survival of terms

### *Noncompetes, etc.*

Look for the main takeaways in the following:

- Tango Clause 22.110 - Noncompetition
- Tango Clause 22.22 - Blue Pencil Request
- Tango Clause 22.111 - Nonsolicitation

## Wed. Apr. 07: Selected provisions

Skim the following except as otherwise indicated.

### *Selected general provisions (2)*

- Tango Clause 22.11 - Assignment Consent: read carefully
- Tango Clause 22.68 - General Representations
- Tango Clause 22.72 - Government Subcontract Disclaimer
- Tango Clause 22.91 - Labor-Law Rights
- Tango Clause 22.97 - Letters of Intent: focus on what's *enforceable* (also Tango Clause 22.148 - Subject to Contract Definition)
- Tango Clause 22.109 - No-Shop: applicable almost exclusively to merger- and acquisition deals
- Tango Clause 22.117 - Other Necessary Actions: often included in M&A agreements
- Tango Clause 22.118 - Past Dealings Disclaimer: note the commentary that this clause is likely to be a bad idea

### *Selected defined terms*

- Tango Clause 22.2 - Affiliate Definition: affiliate status can sometimes be important
- Tango Clause 22.6 - And/Or Definition: a soapbox issue of mine
- Tango Clause 22.49 - Discretion Definition: this sometimes gets litigated
- Tango Clause 22.77 - Including Definition
- Tango Clause 22.104 - Midnight Definition: is "12 midnight" at the *beginning*, or the *end*, of the day?
- Tango Clause 22.125 - Prompt *(adjective)* Definition: "prompt" and "promptly are handy because they're less categorical than "immediately"
- Tango Clause 22.165 - Will Definition: see mainly the commentary

## Mon. Apr. 12: Disputes (1)

Each of the following is worth a careful reading, because similar provisions regularly show up in draft contracts.

### *Keeping disputes from getting out of hand*

- Tango Clause 22.57 - Escalation of Disputes
- Tango Clause 22.93 - Lawyer Involvement
- Tango Clause 22.105 - Mini-Trial to Senior Management
- Tango Clause 22.19 - Baseball Arbitration

*Litigation*

- Tango Clause 22.63 - Forum Selection
- Tango Clause 22.89 - JURY TRIAL WAIVER
- Tango Clause 22.56 - Equitable Relief
- Tango Clause 22.24 - Bond Waiver
- Tango Clause 22.52 - Dispute Management
- Tango Clause 22.14 - Attorney Fees - American Rule
- Tango Clause 22.16.1.4 - The "Texas rule": *Some* contract *claimants* can recover fees
- Tango Clause 22.16.1.6 - The "California rule": It's *all* "prevailing party"

## Wed. Apr. 14: Disputes (2)

*Limitations of liability*

- Chapter 17: Limitations of liability
- Chapter 18: Exclusive remedies
- Tango Clause 22.35 - Consequential Damages Exclusion
- Tango Clause 22.39 - Damages Cap General Terms
- Tango Clause 22.99 - Limitation of Liability Effect
- Tango Clause 21.7 - Liquidated damages (reading)

*Arbitration*

- Tango Clause 22.7 - Arbitration: Focus on the enforceability of arbitration clauses, and *who decides* whether a given dispute is or isn't arbitrable

## Mon. Apr. 19: Business planning

- Chapter 19: Business planning: skim for background; you won't be tested on it
- Tango Clause 22.4 - Amendments: because changing a contract after signing might be … difficult
- Tango Clause 22.5 - Amendments (Unilateral)

## 1.4 Drafting/redrafting exercises: 100 pts

For each of the drafting/redrafting exercises below, email me a Word document **no later than the start of class on the due date**; *one or two points off for late submission*.

Collaboration with others *on the drafting exercises* is fine (and encouraged), but if you do, please put a note to that effect in the Word document so I'll know it wasn't just copying.

"P/F" means Pass-Fail.

### Monday Jan. 25: Signature blocks — 5 pts P/F

Draft the signature blocks for a Gigunda-MathWhiz agreement. Use the hypothetical facts given — and for those facts that aren't given, either:

- use placeholders such as "[INSERT FULL LEGAL NAME]" etc.; or
- leave blank lines for the signer(s) to fill in the appropriate information, e.g., date signed.

*Be sure to review the examples and guidelines at § 3.7.*

### Wed. Jan. 27: Preamble — 5 pts P/F

Draft a preamble for a services agreement between MathWhiz and Gigunda; use the facts given in Section 1.2: and leave placeholders — e.g., "[FILL IN ADDRESS FOR NOTICE]" — for anything else you think you need.

*Be sure to review the examples and guidelines at Section 3.5: .*

### Mon. Feb. 01: Tenant audit rights (Mon. Feb. 01, 5 pts P/F)

**Part 1:** Rewrite the following, from this real-estate lease:

- to break up the "wall of words"
- to be more reader-friendly, as though you were *talking* to a lay jury; and
- to correct any drafting-type "issues" that you see, such as:

- passive voice;
- D.R.Y. issues;
- run-on sentences.

(Don't worry about fixing the substance of the provision — yet.)

> **6.5 Tenant's Audit Rights.** Landlord shall keep reasonably detailed records of all Operating Expenses and Real Estate Taxes for a period of at least two (2) years. Not more frequently than once in every 12-month period and after at least twenty (20) days' prior written notice to Landlord, Tenant together with any representative of Tenant shall be permitted to audit the records of the Operating Expenses and Real Estate Taxes. If Tenant exercises its audit rights as provided above, Tenant shall conduct any inspection at a reasonable time and in a manner so as not to unduly disrupt the conduct of Landlord's business. Any such inspection by Tenant shall be for the sole purpose of verifying the Operating Expenses and/or Real Estate Taxes. Tenant shall hold any information obtained during any such inspection in confidence, except that Tenant shall be permitted to disclose such information to its attorneys and advisors, provided Tenant informs such parties of the confidential nature of such information and uses good faith and diligent efforts to cause such parties to maintain such information as confidential. Any shortfall or excess revealed and verified by Tenant's audit shall be paid to the applicable party within thirty (30) days after that party is notified of the shortfall or excess to the extent such overage or shortfall has not previously been adjusted pursuant to this Lease. If Tenant's inspection of the records for any given year or partial year reveals that Tenant was overcharged for Operating Expenses or Real Estate Taxes by an amount of greater than six percent (6%), Tenant paid such overage and such overage was not otherwise adjusted pursuant to the terms of this Lease, Landlord shall reimburse Tenant for its reasonable, third party costs of the audit, up to an amount not to exceed $5,000.

**Part 2:** What changes you might want to make if you were representing *Landlord*?

## Mon. Feb. 15: Signatures - the Addams family - 5 pts P/F

FACTS:

1. Your client is Addams Investments, L.P., a "family" limited partnership of the very-wealthy Addams clan in Galveston. The sole general partner of the limited partnership is Addams Operations, Inc.

2. It's 12:00 noon Houston time on March 31. The president of Addams Operations, Ms. Wednesday Addams, is on the phone. It's a bad connection, but she wants to talk about a contract that you and she have been negotiating for Addams Investments, L.P.

3. Under the contract, will buy a large quantity of widgets from Widgets, Inc., a Houston company that recently went public. (Family patriarch Gomez Addams is convinced the family will make a killing in the widget market.)

4. Wednesday Addams says that she has talked by phone with her opposite number at Widgets, Inc.; she reports that Widgets, Inc., has agreed to the last contract draft that you sent over, and that everyone is ready to sign.

5. The Widgets, Inc. people really, *really* want to get the contract signed and delivered today, March 31. They've told Wednesday Addams that they're willing to make significant pricing concessions to make that happen.

6. There's a problem, though: As you learn from Wednesday Addams over the bad phone connection, she and the rest of the Addams family are at the end of a rugged backpacking vacation on a small, primitive island in Hawai'i. The island has no Internet service and barely has cell phone service.

7. The family has just emerged from the back country. The plan is for everyone, smelly as they are, to take a private plane from a dirt landing strip on the island to the Honolulu airport. A shuttle bus will take them to a nearby hotel for a quick shower and change of clothes. The family will then board a United Airlines "redeye" overnight flight that will land in Houston on the morning of April 1.

8. One more thing, she says: In the interest of traveling as light as possible, no one in the group brought a laptop.

EXERCISE: Draft the signature block for Addams Investments, L.P.

QUESTIONS to answer in the Word document:

1. Why might the Widgets sales rep be so eager to get the contract signed on March 31? (*Hint:* It has to do with the fact that Widgets, Inc. is a newly-public company.)

2. What about just signing it on April 1 when the family gets back to Houston?

3. Is it physically possible for you to "make it happen" for the contract to be signed and delivered to Widgets, Inc. today, March 31? If so, how might you go about it?

4. If Wednesday Addams asks *you* to sign it as the company's lawyer, how should you respond?

### Mon. Feb. 22: Short employment agreement - 20 pts P/F

### Mon. Mar. 01: Earn-out computations - 10 pts P/F

Simplify the following provision:

(c) Within sixty (60) days after the end of an applicable Earn-Out Year, Purchaser shall (i) prepare or cause to be prepared a statement setting forth: (A) following Year One, the calculation of the Annual Earn-Out Payment applicable to Year One; (B) following Year Two, the calculation of the Annual Earn-Out Payment applicable to Year Two; (C) following Year Three, the calculation of the Annual Earn-Out Payment applicable to Year Three; (D) following Year Four, the calculation of the Annual Earn-Out Payment applicable to Year Four and (E) following Year Five, the calculation of the Annual Earn-Out Payment applicable to Year Five (with respect to each Earn-Out Year, an "Earn-Out Calculation") and (ii) deliver the applicable Earn-Out Calculation to Seller, together with (A) reasonable supporting documents and (B) payment to Seller, by wire transfer of immediately available funds to an account designated in writing by Seller, of the Annual Earn-Out Payment, if any, calculated by Purchaser to be payable based on such Earn-Out Calculation. Seller shall have a period of thirty (30) days after receipt of the applicable Earn-Out Calculation with respect to the applicable Earn-Out Year to notify Purchaser in writing of Seller's election to accept or reject such Earn-Out Calculation as prepared by Purchaser. In the event Seller rejects in writing such Earn-Out Calculation as prepared by Purchaser, such rejection notice (the "Rejection Notice") shall contain the reasons for such rejection in reasonable detail and set forth the amount of the requested adjustment. In the event no Rejection Notice is received by Purchaser during such thirty (30)-day period, the Annual Earn-Out Payment for such Earn-Out Year (as set forth in Purchaser's Earn-Out Calculation) shall be deemed to have been accepted and shall be final, conclusive and binding on the Parties hereto. In the event that Seller shall timely reject an Earn-Out Calculation, Purchaser and Seller shall promptly (and in any event within thirty (30) days following the date upon which Purchaser received the applicable Rejection Notice from Seller rejecting such Earn-Out Calculation) attempt in good faith to make a joint determination of the Annual Earn-Out Payment for the applicable Earn-Out Year, and such determination and any required adjustments resulting therefrom shall be final, conclusive and binding on the Parties hereto. In the event Seller and Purchaser are unable to agree upon the Annual Earn-Out Payment for the applicable Earn-Out Year within such thirty (30)-day period, then Purchaser and Seller shall jointly engage the Accounting Firm to resolve such dispute and promptly submit such dispute for resolution to the Accounting Firm. The Parties shall jointly instruct the Accounting Firm to make a determination within thirty (30) days after its engagement or as soon as practicable thereafter. The Accounting Firm's determination shall be limited to resolving the disagreement set forth in the Rejection Notice. The determination of the Accounting Firm and any required adjustments resulting therefrom shall be final, conclusive and binding on all the Parties hereto. The fees and expenses of the Accounting Firm shall be allocated between and paid by Purchaser and/or Seller, respectively, based upon the percentage that the portion of the contested amount not awarded to each Party bears to the amount actually contested by such Party, as determined by the Accounting Firm.

## Mon. Mar. 08: Termination clause (10 pts., P/F)

This exercise concerns the agreement-termination provision below, from the agreement by which Verizon acquired Yahoo!.

FIRST: Look at the abomination that is subdivision (b)(i):

> This Agreement may be terminated at any time prior to the Closing, whether before or after the Seller Stockholder Approval is obtained, as follows: …
>
> **(a)** *[omitted]*
>
> **(b)** by either Seller or Purchaser, if:
>
> (i) the Closing shall not have occurred by April 24, 2017 (the "Outside Date"); provided, that (A) if the SEC shall not have cleared the Proxy Statement by March 10, 2017, then either party (provided that it has complied in all material respects with its obligations under Section 4.02(a)) may, by written notice delivered to the other party, extend the Outside Date by three (3) months; and (B) if on the fifth (5th) Business Day prior to the Outside Date (including as extended one time pursuant to Section 6.01(b)(i)(A) or this Section 6.01(b)(i)(B)) the conditions set forth in Section 5.01(b) and Section 5.01(c) (solely on account of a temporary or preliminary Governmental Order) are not satisfied, but all other conditions set forth in Article V shall have been satisfied or waived (excluding conditions that, by their terms, cannot be satisfied until the Closing, which conditions would be capable of being satisfied at such time), then either Seller or Purchaser (provided that it has complied in all material respects with its obligations under Section 4.05) may, by written notice delivered to the other party hereto, extend the Outside Date by three (3) months; provided, further, that the right to terminate this Agreement under this Section 6.01(b)(i) shall not be available to a party, if any failure by such party to fulfill its obligations under this Agreement shall have been the primary cause of, or shall have resulted in, the failure of the Closing to occur on or prior to the Outside Date (as extended pursuant to clause (A) or clause (B) of this Section 6.01(b)(i)) ….
>
> *[remaining subparagraphs omitted]*

SECOND: Take a stab at rewriting the following subdivision b(ii) by breaking up the "wall of words" — each subparagraph should address one

> This Agreement may be terminated at any time prior to the Closing, whether before or after the Seller Stockholder Approval is obtained, as follows: …
>
> **(a)** *[omitted]*
>
> **(b)** by either Seller or Purchaser, if:
>
> (i) *[omitted - it's shown under FIRST above]*
>
> (ii) any Governmental Authority of competent jurisdiction shall have issued or entered any Governmental Order or taken any other action permanently

> restraining, enjoining or otherwise prohibiting or making illegal the consummation of any of the Sale and the Reorganization Transactions, and such Governmental Order or action shall have become final and non-appealable; provided, however, that the party seeking to terminate this Agreement pursuant to this Section 6.01(b)(ii) shall have used its reasonable best efforts to remove such Governmental Order or other action; and provided, further, that the right to terminate this Agreement under this Section 6.01(b)(ii) shall not be available to a party whose failure to fulfill its obligations under this Agreement shall have been the primary cause of, or shall have resulted in, the issuance of such Governmental Order or taking of such action; or
>
> *[remaining subparagraphs omitted]*

I'll show my rewrite in due course.

> *[Without redlining]*
>
> This Agreement may be terminated at any time prior to the Closing, whether before or after the Seller Stockholder Approval is obtained, as follows: …
>
> **(a)** *[omitted]*
>
> **(b)** by either Seller or Purchaser, if:
>
> (i) *[omitted]*
>
> (ii) subject to subdivisions (XX) and (YY): any Governmental Authority of competent jurisdiction has issued or entered any Governmental Order or taken any other action permanently restraining, enjoining or otherwise prohibiting or making illegal the consummation of any of the Sale and the Reorganization Transactions, and such Governmental Order or action has become final and non-appealable; or
>
> *[other subparagraphs omitted]*
>
> (XX) A party seeking to terminate this Agreement pursuant to this Section 6.01(b)(ii) must have used its reasonable best efforts *[???]* to remove such Governmental Order or other action.
>
> (YY) A party may not terminate this Agreement under this Section 6.01(b)(ii) if that party's failure to fulfill its obligations under this Agreement was the primary cause of, or resulted in *[QUESTION: Does "resulted in" swallow "primary cause"?]*, the issuance of such Governmental Order or taking of such action

## Mon. Apr. 05: Gross-up provision (10 pts., P/F)

TEXT: From this guaranty:

> **2. No Setoff or Deductions; Taxes; Payments**. The Guarantor represents and warrants that it is organized in the United States of America. The Guarantor shall make all payments hereunder without setoff, counterclaim, restrictions or condition, and free and clear of and without deduction

> for any taxes, levies, imposts, duties, charges, fees, deductions or withholdings of any nature now or hereafter imposed or levied by any jurisdiction or any political subdivision thereof or taxing or other authority therein unless the Guarantor is compelled by law to make such deduction or withholding. *If any such obligation (other than one arising (i) with respect to taxes based on or measured by the net income or profits of the Lender, or (ii) with respect to any withholding tax to the extent that such withholding tax would have been imposed on the relevant payment to the Lender under the laws and treaties in effect at the time such Lender first became a party to this Agreement or otherwise became entitled to any rights hereunder) is imposed upon the Guarantor with respect to any amount payable by it hereunder, the Guarantor will pay to the Lender, on the date on which such amount is due and payable hereunder, such additional amount in U.S. dollars as shall be necessary to enable the Lender to receive the same net amount which the Lender would have received on such due date had no such obligation been imposed upon the Guarantor.* The Guarantor will deliver promptly to the Lender certificates or other valid vouchers (to the extent available) for all taxes or other charges deducted from or paid with respect to payments made by the Guarantor hereunder. The obligations of the Guarantor under this paragraph shall survive the payment in full of the Guaranteed Obligations and termination of this Guaranty.

EXERCISE:

1. Break up this provision. (*Consider:* Does the first sentence in this provision really belong here, given the subheading of the provision?)

2. Rewrite *just the italicized portion* to be more reader-friendly, as though you were *talking* to a lay jury.

### Mon. Apr. 19: Referral agreement (30 pts., NOT P/F)

FACTS: MathWhiz wants to have a *simple* agreement form under which MathWhiz can pay a referral commission to individuals and/or organizations that refer business to it. The amount of the commission will be 5% of the first sale that MathWhiz makes to a given customer.

EXERCISE: Draft such a form.

- *Don't* necessarily include all the bells and whistles of the Tango Terms referral provisions — remember, MathWhiz wants a simple agreement that ideally can get signed without the other side getting its lawyer(s) involved.
- Consider putting key business details in a schedule at the beginning

## Chapter 2 **What can "a contract" look like?**

Much of this section should already be familiar to 2L- and 3L law students: It addresses some of the basics of *forming* a legally-binding contract.

Contents:



## 2.1 Basic requirements for a contract

An agreement will typically be legally binding as a contract if it meets the usual requirements, such as:

1. One party must make an offer, and the other party must accept the offer, so that it's clear that there's been a "meeting of the minds."

2. Both parties have the legal capacity to enter into contracts — a child or an insane person likely would *not* have legal capacity, nor might some unincorporated associations.

3. "Consideration" must exist; roughly speaking, this means that the deal must have something of value in it for each party — and the "something" can be most anything of value, including for example:

    - a promise to do something in the future, or
    - a promise *not* to do something that the promising party has a legal right to do; this is known as "forbearance."

**Caution:** In some circumstances, a showing of consideration might not be necessary, such as in a "contract under seal" under English law and in the doctrine of promissory estoppel, both of which are beyond the scope of this essay.

## 2.2 A short letter agreement might well be enough

Business people aren't fond of spending time negotiating contract terms and conditions. One approach to getting to signature quickly, *for low-risk business contracts*, was dubbed "Pathclearer" by the in-house counsel who developed it at Scottish & Newcastle, a brewery in the UK. The Pathclearer approach entails: (1) using *short letter agreements* instead of long contracts, and (2) *relying on the general law and commercial motivations* — i.e., each party's ability to walk away, coupled with each party's desire to retain a good supplier or customer — to fill in any remaining gaps in coverage.

> See Steve Weatherley, Pathclearer: A more commercial approach to drafting commercial contracts, Practical L. Co. L. Dept. Qtrly, Oct.-Dec. 2005, at 40 (emphasis added).

(For another example of contract shortening, by a General Electric unit, see § 7.4.)

Here's another real-world example from years ago, not long after the present author started work as an associate at Arnold, White & Durkee. One day, the senior name partner, Tom Arnold, asked me to come to his office.

> A personal note: Tom Arnold (1923-2009) founded the law firm Arnold, White & Durkee, which grew to become what we think was the second-largest intellectual property boutique in the United States, with some 150 lawyers in six cities across the country. (In 2000, after I'd gone in-house with a client, the firm merged with Howrey & Simon.) Tom was everything a lawyer should be; multiple lawyers *outside* the firm told me that Tom was very likely the best-known IP attorney in the world. Tom hired me at the firm, I think in part because we'd both been Navy engineering officers, with his service coming during World War II. For many years Tom and his wife, the aptly named Grace Gordon Arnold (1926-2015), were very good to my wife and me; I'm proud to have been Tom's law partner and friend.

Tom asked me to draft a confidentiality agreement for a friend of his, "Bill," who was going to be disclosing a business plan to Bill's friend "Jim." Tom instructed me not to draft a conventional contract. Instead, the confidentiality agreement was to take the form of a letter along approximately the following lines:

> Dear Jim,
>
> This confirms that I will be telling you about my plans to go into business *[raising tribbles, let's say]* so that you can evaluate whether you want to invest in the business with me. You agree that unless I say it's OK, you won't disclose what I tell you about my plans to anyone else, and you won't use that information yourself for any other purpose. You won't be under this

> obligation, though, to the extent that the information in question has become public, or if you get the information from another legitimate source.
>
> If this is agreeable, please countersign the enclosed copy of this letter and return it to me. I look forward to our working together.
>
> Sincerely yours,
>
> Bill

When I'd prepared a draft, I showed it to Tom and asked him, *isn't this pretty sparse?* Tom agreed that yes, it was sparse, **but**:

- The signed letter would be a binding, enforceable, workable contract, *which Bill could take to court* if his friend Jim double-crossed him (which Bill judged to be very unlikely); and
- Equally important to Bill: *Jim would probably sign the letter immediately*, whereas if Bill had asked Jim to sign a full-blown confidentiality agreement, Jim likely would have asked his lawyer to review the full-blown agreement, and that would have delayed things — not just by the amount of time it took Jim's lawyer to review the agreement, but for the parties to negotiate the changes that the lawyer likely would have requested.

That experience was an eye-opener. It taught me that contracts aren't magical written incantations: they're just simple statements of simple things.

The experience was also my first lesson in a fundamental truth: **Business clients are often far more interested in being able to sign an "OK" contract *now*** than they are in signing a supposedly-better contract weeks or more in the future.

As another example of a short-form contract in letter form, see the 2006 letter agreement for consulting services between Ford Motor Company and British financial wizard Sir John Bond — consisting of an introduction, six bullet points, and a closing.

> The Ford-Bond letter agreement is archived at https://perma.cc/53XV-43TD.

Tangentially related, in a dictum, the Ninth Circuit noted: "If the copyright holder agrees to transfer ownership to another party, that party must get the copyright holder to sign a piece of paper saying so. It doesn't have to be the Magna Charta; a one-line pro forma statement will do."

> Effects Assoc., Inc. v. Cohen, 908 F.2d 555, 557 (9th Cir. 1990) (affirming summary judgment).

## 2.3 Even emails can form binding contracts

**Pro tip:** Some might be surprised that in the United States (and the UK, and probably other jurisdictions), you can form a legally-binding contracts *by exchanging emails*, as long as the following conditions are satisfied:

- the emails must meet the standard requirements for contracts such as offer, acceptance, and consideration — this (usually) isn't an issue for everyday business agreements, especially because email attachments and any terms incorporated by reference will be considered part of that content; and
- the emails must include "signatures" for each party, which can take the form of email signature blocks and even names in email "From" fields.

This has been true for a number of years; in various cases, courts have held that exchanges of *emails* were sufficient to form binding contracts for:

• the sale of real property;

> See Perkins v. Royo, No. C080748, slip op. (Cal. App.—3d Dist. Mar. 6, 2018) (affirming judgment on jury verdict) (unpublished).

• the sale of goods;

> See, e.g., J.D. Fields & Co., Inc. v. Shoring Engineers, 391 F. Supp. 3d 698, 703-04 (S.D. Tex. 2019) (denying motion to dismiss for lack of personal jurisdiction; emails (including one with a signed sale quotation) established a contract for sale of steel piping that incorporated general terms & conditions containing enforceable mandatory forum-selection clause).

• an agreement to design and produce materials for a construction project in Saudi Arabia;

> See Gage Corp., Int'l v. Tamareed Co., 2018 WI App 71, 384 Wis. 2d 632, 922 N.W.2d 310 (2018) (per curiam, affirming judgment on jury verdict; unpublished).

• the sale of 88 rail freight cars;

> See APB Realty, Inc. v. Georgia-Pacific LLC, 889 F.3d 26 (1st Cir. 2018) (vacating dismissal; complaint stated a claim for breach of contract formed by email).

• a broker's commission for a real-estate transaction;

> See Newmark & Co. Real Estate Inc. v. 2615 E. 17 St. Realty LLC, 80 A.D.3d 476, 477-78, 914 N.Y.S.2d 162 (N.Y. App. 2011).

• an employment agreement including nine months' severance pay in case of termination;

> See Nusbaum v. E-Lo Sportswear LLC, No. 17-cv-3646 (KBF), slip op. (S.D.N.Y. Dec. 1, 2017) (granting former employee's motion for summary judgment). Here, though, the court said: "While the series of emails does not qualify as *a signed writ-*

*ing*, under the *Winston* factors, they form a binding contract" because "[t]he emails demonstrate a 'meeting of the minds' on essential terms" and under New York law "[a] contract does not need to be signed to be binding on the parties." *Id.*, slip op. at 9 (emphasis added).

- a compromise of a past-due bill for legal fees;

  See Preston Law Firm v. Mariner Health Care Management, 622 F.3d 384 (5th Cir. 2010) (reversing district court; emails created binding compromise).

- settlement of a lawsuit.

  See, e.g., Dharia v. Marriott Hotel Services, Inc., No. CV 18-00008 HG-WRP, slip op. (D. Haw. Jun. 28, 2019) (enforcing email agreement to mediator's settlement proposal); Jarvis v. BMW of North America, LLC, No. 2:14-cv-654-FtM-29CM, slip op. (M.D. Fla. 2016) (granting motion to enforce settlement agreement; citing Florida and 11th Cir. cases); JBB Investment Partners Ltd. v. Fair, No. A152877, slip op. (Cal. App.—1st Dist. Jun. 4, 2019) (affirming grant of motion to enforce settlement agreement and imposing sanctions for frivolous appeal) (unpublished); Martello v. Buck, No. B285001, slip op. (Cal. App. 2d Dist. Mar. 1, 2019) (affirming dismissal of lawsuit pursuant to settlement agreement reached by email); Amar Plaza, Inc. v. Rampart Properties, Inc. , No. B254564, slip op. (Cal. App.—2d Div. Feb. 29, 2016) (granting motion to dismiss appeal; emails established that parties had reached binding settlement agreement) (unpublished); Forcelli v. Gelco Corp., 109 A.D.3d 244, 72 N.Y.S.2d 570 (N.Y. App. Div. 2013); Williamson v. Delsener, 59 A.D.3d 291, 874 N.Y.S.2d 41 (N.Y. App. 2009) (enforcing settlement agreement).

New York's highest court held that an exchange of emails — "in essence, we 'offer' and 'I accept,' … sufficiently evinces an objective manifestation of an intent to be bound for purposes of surviving a motion to dismiss."

> Kolchins v. Evolution Markets, Inc., 31 N.Y.3d 100, 107-08, 96 N.E.3d 784, 73 N.Y.S.3d 519, text accompanying n.5 (2018); see also, e.g., Naldi v. Grundberg, 80 A.D.3d 1, 908 N.Y.S.2d 639 (N.Y. App. Div. 2010).

Of course, an email exchange will *not* create a binding contract if the *content* of the emails fails to meet the usual requirements of establishing a meeting of the minds on all material terms as well as an agreement to be bound.

> See, e.g., Beauregard v. Meldon, No. 19-10342-RGS, slip op. (D. Mass. Dec. 17, 2019) (granting defendant's motion for summary judgment dismissing claim for breach of contract); Universal Atlantic Sys. v. Honeywell Int'l, 388 F. Supp. 3d 417, 428-30 (E.D. Pa. 2019) (same); Tindall Corp. v. Mondelez Int'l, Inc., 248 F. Supp. 3d 895, 906-07 (N.D. Ill. 2017) (same); Naldi v. Grundberg, 80 A.D.3d 1, 3, 6-7, 908 N.Y.S.2d 639 (N.Y. App. Div. 2010) (reversal of denial of motion to dismiss complaint for breach of contract; citing cases).

BUT: Even without a binding *written* contract, an email trail can provide evidentiary support for a jury verdict that an *oral* contract was formed (presupposing that the Statute of Frauds doesn't preclude an oral contract).

> See Hawes v. Western Pacific Timber LLC, No. 47133 (Id. Dec. 18, 2020) (affirming judgment on jury verdict for breach of oral agreement to pay severance).

## 2.4 Contracts by IM or text message?

**Pro tip:** Even a very-terse exchange of text messages or instant messages ("IM") can create a binding contract. For example:

• Two Texas furniture dealers entered into an agreement — entirely by text message — for one party to sell the entire contents of a furniture showroom to the other. When the seller backed out, the court had no difficulty holding that the parties had entered into an enforceable contract.

> See Moe's Home Collection, Inc. v. Davis Street Mercantile, LLC, No. 05-19-00595-CV, slip op. at 6-10 (Tex. App.—Dallas June 6, 2020) (affirming judgment below in relevant part).

• In a federal-court lawsuit in Florida (decided under Delaware law), an IM exchange between a digital ad agency and an e-cigarette manufacturer served as a binding agreement to increase the ad agency's budget for placing online ads for the e-cigarettes. The crux of the IM exchange started with a message from an account executive at the ad agency: "We can do 2000 [ad placement] orders/day by Friday if I have your blessing"; the manufacturer's VP of advertising responded: "NO LIMIT," to which the account executive responded: "awesome!" That series of messages served to modify the parties' contract; as a result, the manufacturer had to pay the ad agency more than a million dollars in additional fees.

> See CX Digital Media, Inc. v. Smoking Everywhere, Inc., No. 09-62020-CIV, slip op. at 8, 17-18 (S.D. Fla. Mar. 23, 2011).

**Caution:** When it comes to real-estate contracts, California's version of the Statute of Frauds states that: "An electronic message of an ephemeral nature *that is not designed to be retained or to create a permanent record*, including, but not limited to, a text message or instant message format communication, *is insufficient* under this title to constitute a contract to convey real property, in the absence of a written confirmation that conforms to the requirements of *[citation omitted]*."

> Cal. Civ. Code § 1624(d) (emphasis added).

## 2.5 Will *all* written agreements be legally binding?

It's not uncommon for parties to engage in preliminary discussions, by email or text, about a potential transaction or relationship — but then the discussions

end and one party claims that the parties had reached a legally-binding written agreement.

**Pro tip:** It's quite common for written contracts to include a binding-agreement declaration in the general-provisions section. Drafters who do so are generally desirous of setting up a roadblock to head off "creative" arguments to the contrary by another party's counsel.

*Caution:* Just saying "this is binding" won't necessarily make it so; if one of the necessary requirements isn't met (see above), then a court might hold that the agreement was not binding, no matter what it said. But it can't hurt to say that the parties *intend* for the agreement to be binding.

*Example:* On the other hand, early written communications between the parties might say, in effect, "this is *not* binding!":

- A party might include, in an email or other message, an express disclaimer of any intent to be bound.
- If parties sign a so-called letter of intent ("LOI"), the LOI might state explicitly that the parties do *not* intend to be bound (except perhaps to a very-limited extent, e.g., perhaps by confidentiality provisions). See the Tango "Letter of Intent" terms for examples.

## 2.6 Reminder: Many *oral* contracts can be binding

There's an old law-student joke that an oral contract isn't worth the paper it's printed on. But that's not quite true: Oral contracts are "a thing," and long have been.

> This section uses the term *oral* contract, because strictly speaking a *written* contract is also "verbal," that is to say, "of, relating to, or consisting of words." See *Verbal (adjective)*, at https://www.merriam-webster.com/dictionary/verbal.

Whether an oral agreement is *enforceable* as a contract depends on the evidence that's brought before the court; enforceability basically depends on two things:

1. The contract cannot be of a type that, by law, *must* be in writing (see the discussion at § 2.7); and

2. The jury,* after hearing the witness testimony and weighing the evidence, must find that there was, *in fact*, an oral agreement. (* *Or the judge in a nonjury trial, or the arbitrator in an arbitration*.)

As noted above, an email trail can provide evidentiary support for a jury verdict that an *oral* contract was reached.

> See Hawes v. Western Pacific Timber LLC, No. 47133 (Id. Dec. 18, 2020) (affirming judgment on jury verdict for breach of oral agreement to pay severance).

As another example, a small Texas company fired its accounting director as part of a corporate reorganization. The fired employee sued for breach of an alleged oral promise to pay him a bonus. The fired employee testified under oath that he had been promised, by the company's vice president of operations, that he *would* get a bonus, not merely that he *might* get a bonus. The jurors believed the employee; they didn't buy the company's claim that the employee had been told only that he *might* get a bonus.

> See Elaazami v. Lawler Foods, Ltd., No. 14-11-00120-CV, slip op. at part III (Tex. App—Houston [14th Dist.] Feb. 7, 2012) (citing cases).

Now recall that under standard American legal principles — including the Seventh Amendment to the U.S. Constitution — if a reasonable jury *could* reach the verdict that the actual jury did, then the actual jury's verdict must stand (with certain exceptions).

Incidentally, under *Texas* law, the fired employee was also entitled to recover his attorney fees for bringing the lawsuit, under section 38.001 of the Texas Civil Practice & Remedies Code.

## 2.7 But: The Statute of Frauds might say otherwise

For public-policy reasons, the law will not allow some oral agreements to be enforced. For some types of contract, in effect, the law says: *For* this type *of contract, we want to be very sure that the parties really, truly did agree. So we're not going to just take one party's word for it — even that party swears under oath that the parties did agree, we still want to see it in writing*.

This public policy is reflected in the Statute of Frauds, which says (in various versions) that certain types of contract are not enforceable unless they're documented in signed writings (or unless one of various exceptions applies).

The typical types of contract subject to the Statute of Frauds are:

1. prenuptial agreements and other contracts in consideration of marriage;

2. contracts that *cannot* be performed within one year, such as an agreement to employ someone for, say, two years (this usually excludes contracts that don't specify any duration at all);

3. contracts that call for transfer of an ownership interest of land (or similar interests in land such as an easement);

4. contracts in which the executor of a will agrees to use the executor's own money to pay a debt of the estate;

5. contracts for the sale of goods for $500.00 or more (the exact amount might vary);

6. guaranty agreements in which one party agrees to act as a surety (guarantor) for someone else's debt.

**Caution:** Even an oral contract that's subject to the Statute of Frauds might be enforced if one of the various exceptions applies, such as partial performance; that's beyond the scope of this discussion.

## 2.8 Agreement to agree? Or "open terms"?

Business people and drafters can sometimes be tempted to say, in a contract, "we don't know what we want to do about Issue X, so we'll leave that for later." Depending on how the contract is worded, that could result in either:

- an *enforceable* agreement with "open terms" *that a court can readily calculate or discern*; or
- as an *unenforceable* agreement to agree.

> See, e.g., Phytelligence, Inc. v. Wash. State Univ., 973 F.3d 1354, 1360-62 (Fed. Cir. 2020) (affirming summary judgment; contract was an unenforceable agreement to agree).

Incidentally: Agreements *to negotiate in good faith*, as opposed to agreements *to agree*, will often be enforceable.

> See also the Tango Terms definition of "good faith."

## 2.9 Battle of the Forms

Contracts can arise when parties throw paper at each other in the course of doing a transaction; this can cause problems when conflicting terms exist in the parties' respective paper.

### 2.9.1 The problem: Dueling standard forms

When a corporate buyer makes a significant purchase, it's extremely common (and essentially a universal practice) for the buyer's procurement people to send the seller a purchase order. Typically, the seller's invoice must include the purchase-order number — otherwise the buyer's accounts-payable depart-

ment simply won't pay the bill. These are routine internal-controls measures that are almost-uniformly implemented by buyers to help prevent fraud.

But many buyers try to use their purchase-order forms, not just for fraud prevention, but to impose legal terms and conditions on the seller as well. Some buyers put a great deal of fine print on the "backs" of their purchase-order forms (physically or electronically).

Such fine-print terms often include:

- detailed — and often onerous — terms and conditions for the purchase, such as expansive warranties, remedies, and indemnity requirements; and
- language to the effect of, *only our terms and conditions will apply — your terms won't count, no matter what happens.*

For example, a Honeywell purchase-order form states in part — in the very first section — as follows:

> Honeywell rejects any additional or inconsistent terms and conditions offered by Supplier at any time.
>
> Any reference to Supplier's quotation, bid, or proposal does not imply acceptance of any term, condition, or instruction contained in that document.

See Honeywell purchase order form archived at https://perma.cc/CUV6-NKTY, § 1 (extra paragraphing added).

The same section, incidentally, includes this remarkable assertion:

> A purchase order is deemed accepted upon a) the date the Supplier returns the acknowledgment copy of a purchase order to Honeywell or b) *five calendar days from date Honeywell issues the purchase order to Supplier* regardless of mechanism used to convey requirements, whichever is earlier.

(Emphasis added.) In other words: According to Honeywell, if Honeywell sends you a purchase order out of the blue, you're deemed to have accepted the purchase order in five business days. Um … good luck getting a court to go along with *that* proposition ….

Sellers aren't always innocent parties in this little dance, either: It's not uncommon for a seller's quotation to state that all customer orders are subject to acceptance in writing by the seller. Then, the seller's written acceptance of a customer's purchase order takes the form of an "order confirmation" that itself contains detailed terms and conditions — some of which might directly conflict with the terms in the buyer's purchase order.

For example, the first section of a Honeywell terms of *sale* document states in part as follows:

> Unless and to the extent that a separate contract executed between the procuring party ("Buyer") and Honeywell International Inc. ("Honeywell") applies, any purchase order covering the sale of any product ("Product") contained in this Catalog ("Order") will be governed solely by these Conditions of Sale, whether or not this Catalog or these Conditions of Sale are referenced in the Order.
>
> Except as provided in the "Buyer"s Orders" section below, all provisions on Buyer"s Order and all other documents submitted by Buyer are expressly rejected.
>
> Honeywell will not be deemed to have waived these Conditions of Sale if it fails to object to provisions submitted by Buyer.
>
> Buyer"s silence or acceptance or use of Products is acceptance of these Conditions of Sale.

Honeywell terms of *sale* document archived at https://perma.cc/5MB9-H6VK at § 1 (extra paragraphing and bullets added).

In both cases, the "we *spit* on your terms!" language is keyed to section 2-206 of the (U.S.) Uniform Commercial Code, which states in part that for sales of goods:

> (1) *Unless otherwise unambiguously indicated by the language* or circumstances[,]
>
> (a) an offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances ….

UCC § 2-206 (emphasis added).

In each of these forms, the quoted language seems to state pretty clearly that acceptance is limited to the terms stated in the form.

**Important:** Drafters asked to prepare standard forms of this kind should strongly consider whether to include "We reject your terms!" language along these lines.

But it's not unlikely that the parties' *business people* will pay exactly zero attention to these dueling forms. What could easily happen is the following:

- The seller's sales people receive the purchase order and send it to the order-fullfilment department.
- The seller's order-fulfillent department ships the ordered goods — along with a confirmation of sale document and an invoice.
- The buyer's receiving department takes delivery of the ordered goods and puts them into inventor, distributes them to end users, or whatever.
- The buyer's receiving department forwards the seller's invoice to the buyer's accounts-payable department, which in due course pays the invoice.

So whose terms and conditions apply — those of the buyer, or those of the seller? This is known as the "Battle of the Forms," of the kind contemplated by UCC § 2-207 and sometimes experienced in common-law situations as well, to which we now turn.

### 2.9.2 Sidebar: A *buyer* can be a "merchant"

As discussed in the next section, in some situations it can matter whether a party is considered a "merchant." As used in U.S. commercial law, the term *merchant* generally includes not only regular *sellers* of particular types of goods, but also *buyers* who regularly acquire such goods.

The Uniform Commercial Code states as follows in UCC § 2-104(1):

> "Merchant" means a person[:]
>
> - who **deals in** *[i.e., not just sells]* goods of the kind
> - or otherwise by his occupation holds himself out
>   - as having knowledge or skill
>   - peculiar to the practices or goods involved in the transaction
> - or to whom such knowledge or skill may be attributed
>   - by his employment of an agent or broker or other intermediary
>   - who by his occupation holds himself out as having such knowledge or skill.

(Emphasis, extra paragraphing, and bullets added.)

To like effect is UCC § 2-205, which refers to "[a]n offer by a merchant *to buy or sell* goods …."

Federal judge Richard Posner explained the use of the term *merchant* as being different than common parlance:

> Although in ordinary language a manufacturer is not a merchant, "between merchants" is a term of art in the Uniform Commercial Code. It means between commercially sophisticated parties ….
>
> Wisconsin Knife Works v. Nat'l Metal Crafters, 781 F.2d 1280, 1284 (7th Cir. 1986) (Posner, J.) (citations omitted). To similar effect is the UCC definition's commentary, apparently reproduced in Nebraska Uniform Commercial Code § 2-104.

Other cases and commentators have reached the same conclusion.

> ; see, e.g., Brooks Peanut Co. v. Great Southern Peanut, LLC, 746 S.E.2d 272, 277 n.4 (Ga. App. 2013) (citing another case that cited cases); Sacramento Regional Transit v. Grumman Flxible *[sic]*, 158 Cal. App.3d 289, 294-95, 204 Cal. Rptr. 736 (1984) (affirming demurrer), in which the court held that a city's transit district, which had bought buses from a manufacturer, was a merchant within the meaning of

§ 2-104; Douglas K. Newell, The Merchant of Article 2, 7 Val. U. L. Rev. 307, 317, part III (1973).

### 2.9.3 The UCC's solution to the Battle: The Drop-Out Rule

Where sales of *goods* are concerned, the (U.S.) Uniform Commercial Code has a nifty way of dealing with the Battle of the Forms in section 2-207: *When the parties are merchants*:

- whatever terms are common to the parties' respective contract forms is part of "the contract"
- all other terms in both parties' contract forms drop out — left on the cutting-room floor, if you will; and
- the UCC's "default" terms also apply.

Here's the text of UCC § 2-207:

> (1) A definite and seasonable expression of acceptance
>
> or a written confirmation
>
> which is sent within a reasonable time
>
> **operates as an acceptance**
>
> **even though** it states terms additional to or different from those offered or agreed upon,
>
> **unless** acceptance is expressly made conditional
>
> on assent to the additional or different terms.
>
> (2) The additional terms are to be construed as proposals for addition to the contract.
>
> **Between merchants** *[see § 2.9.2 above]* such terms **become part of the contract unless**:
>
> (a) the offer **expressly limits acceptance** to the terms of the offer;
>
> (b) they materially alter it; or
>
> (c) **notification of objection** to them has already been given
>
> or is given within a reasonable time after notice of them is received.
>
> *[DCT comment: Here comes the key part —]*
>
> (3) **Conduct** by both parties which recognizes the existence of a contract
>
> is sufficient to establish a contract for sale
>
> although **the writings** of the parties do not otherwise establish a contract.
>
> **In such case** the terms of the particular contract consist of[:]

> - those terms on which the writings of the parties agree,
> - together with any supplementary terms incorporated under any other provisions of this Act.

(Emphasis, extra paragraphing, and bullets added.)

So suppose that:

- Buyer sends Seller a purchase order with its terms and conditions;
- Seller sends Buyer an order confirmation — with *Seller's* terms and conditions — along with the goods ordered, *and* an invoice.
- Buyer's payables department pays the invoice.

In that situation, the parties have engaged in conduct that recognizes the existence of a contract. The terms of that contract are whatever "matching" terms exist in the parties' respective forms, *plus* the UCC's default provisions.

### 2.9.4 Caution: The UN CISG uses the "mirror image" rule

It's a very-different analysis of the Battle of the Forms under the UN Convention on Contracts for the International Sale of Goods. The Seventh Circuit explained:

> The Convention departs dramatically from the UCC by using the common-law "mirror image" rule (sometimes called the "last shot" rule) to resolve "battles of the forms." With respect to the battle of the forms, the determinative factor under the Convention is when the contract was formed.
>
> The terms of the contract are those embodied in **the last offer** (or counteroffer) made prior to a contract being formed.
>
> Under the mirror-image rule, as expressed in Article 19(1) of the Convention, "[a] reply to an offer which purports to be an acceptance but contains additions, limitations or other modifications is a rejection of the offer and constitutes a counter-offer."

The court affirmed a judgment below that, "because Illinois Trading never expressly assented to the attorney's fees provision in VLM's trailing invoices, under the Convention that term did not become a part of the parties' contracts."

> VLM Food Trading Int'l, Inc. v. Illinois Trading Co., 811 F.3d 247, 250-51 (7th Cir. 2016) (cleaned up and reformatted; alteration by the court).

### 2.9.5 Caution: *Filling* a purchase order might lock in *buyer's* T&Cs

Remember that in U.S. jurisdictions, a customer's sending of a purchase order might count as an offer to enter into a contract, *which could be accepted by performance*, i.e., by filling the purchase order.

Consider the following actual example from a Cisco purchase-order document:

> Supplier's electronic acceptance, acknowledgement of this Purchase Order, *or commencement of performance* constitutes Supplier's acceptance of these terms and conditions.
>
> , Cisco Standard Terms and Conditions of Purchase – United States § 1, archived at https://perma.cc/SD47-YCHU.

If a supplier filled an order on Cisco's paper without sending its own rejection of the Cisco terms, then the supplier might find itself bound by Cisco's terms.

### 2.9.6 Additional reading (optional)

See generally:

- Battle of the Forms – UCC and common-law variations
- Purchase order (Wikipedia)
- Brian Rogers, Battle of the Forms Explained (Using a Few Short Words) (blog entry March 1, 2012).
- Marc S. Friedman and Eric D. Wong, TKO'ing the UCC's 'Knock-Out Rule', in the Metropolitan Corporate Counsel, Nov. 2008, at 47.
- For an eye-glazing set of "battle of the forms" facts, see BouMatic LLC v. Idento Operations BV, 759 F.3d 790 (7th Cir. 2014) (vacating and remanding dismissal for lack of personal jurisdiction) (Easterbrook, J.).
- An existing teaching case is Northrop Corp. v. Litronic Industries, 29 F.3d 1173 (7th Cir. 1994) (Posner, J.): This was a case where the buyer's purchase order stated that the seller's warranty provision was of unlimited duration, but the seller's acknowledgement form stated that the seller's warranty lasted only 90 days. The trial court held, the appellate court agreed, that both of those provisions dropped out of the contract, and therefore the buyer was left with a UCC implied warranty of "reasonable" duration. *Id.* at 1189.

## 2.10 **Exercises & discussion questions**

1. FACTS: Alice and Bob are natural-gas traders. Alice sends Bob an Internet instant message ("IM") offering to sell Bob a stated quantity of natural gas, of a specified, industry-standard quality, for delivery at a specified location and date, at a stated price. Also by IM, Bob responds "Yes." Let's assume there are no defenses to formation such as lack of capacity. QUESTION: Have Alice and Bob entered into an enforceable contract? (Vote "Yes" or "No" using the Zoom participant list voting buttons; Raise Hand if unsure.)

2. True / false / maybe: The terms of a "letter of intent" will generally be non-binding, because that's why parties sign a letter of intent in the first

place. EXPLAIN.

3. FACTS: The CEO of MathWhiz and a VP of Gignda Energy have a lunch meeting in Houston to talk about a quickie data-analysis project that Gigunda wants MathWhiz to undertake the following day.

- The lunch is in a family-style restaurant that has paper "coloring book" placemats, with crayons for kids to use in coloring in the drawings.
- Neither executive thought to bring a pen or pencil, so using crayons to write on the back of one of their placemats, the two executives jot down bullet points for the main terms of the data-analysis project — what MathWhiz will do, the delivery date (the following day), and the fee that Gigunda would pay upon completion.
- Each executive signs and dates the placemat at the bottom.
- The MathWhiz CEO uses her camera to take a picture of the signed placemat, then emails the photo to the Gigunda Energy vice president.
- When the executives leave the restaurant, one of them tears up the placemat, wads it up the strips, and leaves them to be picked up and trashed when the table is bussed.
- QUESTIONS:
    - A) True or false: This is a "verbal" contract. EXPLAIN. -B) True or false: This is a "written" contract.

4. True or false: At least some types of binding contract can be formed by exchanging *emails*.

5. True or false: A contract that *might* be completely performed in a year is invalid under the Statute of Frauds if it turns out that the contract *isn't* completely performed in a year.

6. True or false: At least some types of binding contract can be formed by exchanging *text messages*.

7. True or false: An *oral* contract could be binding, depending on the circumstances.

8. True or false: An email can provide evidence to corroborate the existence of a binding *oral* contract even if the email doesn't itself constitute a binding *written* contract.

9. True or false: For an email contract to be binding, each party's email must include the specific word "Signed" to make it clear that the party is assenting to the terms.

10. True or false: In at least one state, text messages likely won't be enough to form a certain type of contract.

11. True or false: An agreement to agree will generally be enforceable in the U.S. — the court will weigh expert testimony to determine what reasonable parties likely *would* have agreed to.

12. FACTS: A potential customer sends a purchase order to a supplier for 1,000 widgets;

- The purchase order's fine print contains detailed terms and conditions, *including* a rejection of any other terms provided by the supplier.
- The supplier ships the 1,000 widgets to the customer together with an invoice.
- The fine print in the supplier's invoice contains detailed terms and conditions, *including*
  - (i) a rejection of any other terms provided by the customer;
  - (ii) a conspicuous disclaimer of all implied warranties; and
  - (iii) a requirement that all disputes must be resolved by binding arbitratation, not by litigation in court.
- Under the applicable law, all sales of goods include an implied warranty of merchantability unless conspicuously disclaimed in the parties' contract.
- QUESTION: If the customer wants to make a claim against the supplier for breach of the implied warranty of merchantability, must the customer *arbitrate* the claim, or can it bring a lawsuit in court? (Assume for now that the arbitration clause would be enforceable IF the parties agreed to it.)

13. FACTS: A Houston-area *Honda* dealership sells a new Honda to a customer, taking the customer's used *Ford* "in trade."

- Assume (incorrectly) that in Texas, sales of cars are not governed by any special laws other than the Uniform Commercial Code.
- QUESTION: In Texas, is the Honda dealer a "merchant" *as to the used Ford*? Why or why not?
- VARATION: The Honda buyer, instead of trading in a used Ford, offers a bass boat on a trailer. The dealership accepts the trade because the dealership's owner has long wanted to take up fishing again and figures he can use the bass boat to teach his grandchildren how to fish. QUESTION: Is the dealership a "merchant" as to the bass boat?

14. FACTS: Two Houston companies, ABC Corp. and XYZ LLC, enter into a contract for XYZ to build a warehouse on ABC's property in northwest Houston for a stated price.

- Before any work starts on the project at all, the on-the-ground managers for the two companies can't seem to get along. One day, ABC's manager angrily tells her boss that XYZ's construction supervisor told her, "that's it, we're done, find yourself another builder!"
- ABC decides that yes, it'd be better for it to use another builder. So ABC signs a contract with MNOP LLC — at a significantly-higher price — and sues XYZ for breach of contract, asserting that XYZ's construction supervisor repudiated the contract and so XYZ should be liable for the extra cost that ABC would incur by switching to MNOP LLC.
- At the jury trial, ABC's manager testifies under oath that XYZ's construction supervisor said what's described above; in his own testimony, XYZ's supervisor denies this, also under oath.
- QUESTION: What kinds of other evidence could ABC seek to adduce at trial to support its theory of the case — IF it had such evidence?
- QUESTION: If the jury accepts one side's version of events, how easy would it be for the trial judge to overrule the jury's finding at the losing party's request? What about an appellate court? (Hint: See the Seventh Amendment and Fed. R. Civ. P. 50(a) concerning judgment as a matter of law.)
- QUESTION: What does the above tell you about the importance of (i) putting things in writing, and (ii) keeping the writings?

# Chapter 3 **Setting up the contract framework**

Contents:

## 3.1 Finding existing contract forms

Few contract drafters start with a clean sheet of paper — mainly because it's difficult to remember all the issues that might need to be addressed — and so most drafters start with some prior agreement.

Law firms often try to maintain form files, but seldom does anyone get paid or otherwise receive meaningful reward for doing that drudgery. So the quality and currency of law firm form files can be dicey.

Thousands of contract forms are available online from commercial companies that screen and curate contracts filed with the U.S. Securities and Exchanges EDGAR Web site (https://www.sec.gov/edgar/search-and-access). Some of these commercial sites include:

- LawInsider.com (membership required)
- OneCLE.com

Other sites such as RocketLawyer.com and LegalZoom.com offer forms, but it's hard to know what their quality is, nor whether they take into account the "edge cases" that sometimes crop up in real-world situations.

If you want to search the SEC's EDGAR Web site yourself, it helps to know that many if not most contracts will be labeled as Exhibit 10.something (and possibly EX-4.something) under the SEC's standard categorization. This means that the search terms "EX-10" (and/or "EX-4") can help narrow your search.

Example: A quick search and scan turned up the 2019 separation agreement between CBS Corporation (the TV network) and its now-former chief legal officer.

**Pro tip:** Online contract forms are best relied on as sources of ideas for issues to address. The clause language is not necessarily what you'd want to use in a contract for a client.

In some contracts you find online, the "Notices" provision might include the names and addresses of the parties' outside counsel — if counsel are in name-brand firms, that might give you increased confidence. *Example:* In the 2007 real-estate lease between Stanford University (landlord) and Tesla (tenant), the counsel to be notified for Stanford was a partner at Bingham McCutchen, a large Boston-based firm that closed its doors in 2014 when hundreds of its lawyers left to join the Morgan Lewis firm.

**Caution:** Lawyers at blue-chip law firms aren't infallible — and the law-firm partner identified in a contract might not have been the one who actually did the work — so you won't want to assume that the contract is necessarily of A+ quality.

**Caution:** An existing contract will often reflect concessions that were made by one or more parties during negotiations. This means that when drafting a new contract, you should carefully review the existing contract's terms and determine whether that's really where you want to start.

## 3.2 Mindless copy-and-paste can be dangerous

Don't just copy and paste language from an old contract without thoroughly reviewing it. One very-public "fail" on that score occured in the UK's negotiation of its Brexit deal; as reported by the BBC:

> References to decades-old computer software are included in the new Brexit agreement, including a description of Netscape Communicator and Mozilla Mail as being "modern" services.
>
> Experts believe officials must have copied and pasted chunks of text from old legislation into the document.
>
> The references are on page 921 of the trade deal, in a section on encryption technology.
>
> It also recommends using systems that are now vulnerable to cyber-attacks.
>
> The text cites "modern e-mail software packages including Outlook, Mozilla Mail as well as Netscape Communicator 4.x."
>
> The latter two are now defunct - the last major release of Netscape Communicator was in 1997.

See Cristina Criddle, Brexit deal mentions Netscape browser and Mozilla Mail (BBC.com Dec. 29, 2020) (extra paragraphing added); see also, e.g., Ben Quinn, Obsolete software from 1990s features in Brexit deal text (TheGuardian.com Dec. 29, 2020).

## 3.3 A clean sheet of paper has its own hazards

*[For students: Skim this section for background information; all you need to remember for testing purposes is the following "Pro tip."]*

**Pro tip:** Throwing out an existing contract, and starting over with a clean sheet of paper to draft a much-shorter contract, can be dangerous:

- The existing contract might well capture past experience with oddball issues that can cause disputes.
- The drafters of the new, shorter contract might inadvertently overlook one or more of those issues.

A safer approach is to just "clean up" the contract by • breaking its long, "wall of words" provisions into smaller chunks; and • as necessary, rewriting legalese to make it sound more like how you'd explain the concept to a judge or jury.

**Background:** Contract *forms* tend to grow by accretion, as lawyers think of issues that could arise. As a result, what a commenter said about politicians (fearful of voter backlash) might apply equally to contract drafters (fearful of malpractice claims): "[E]fforts to reform airport security are hamstrung by politicians and administrators *who would prefer to inflict hassle on millions than be caught making one mistake*."

> Henry Grabar, Terminal: How the Airport Came to Embody Our National Psychosis (Slate.com 2017) (emphasis added).

That attitude of "cover every conceivable risk" can cause problems. For example: The legal department of one General Electric unit found that its "comprehensive" contracts were getting in the way of closing sales deals:

> When GE Aviation combined its three digital businesses into a single Digital Solutions unit, their salespeople were eager to speed up the growth they had seen in the years before the move. *They found plenty of enthusiastic customers, but they struggled to close their deals*. The reason: Customers often needed to review and sign contracts more than 100 pages long before they could start doing business.
>
> The new business inherited seven different contracts from the three units. The clunky documents were loaded with legalese, redundancies, archaic words and wordy attempts to cover every imaginable legal *[sic]*. No wonder they languished unread for months. "We would call, and customers would say, 'I can't get through this,'" says Karen Thompson, Digital Solutions contracts leader at GE Aviation. "And that was before they even sent it to their legal team! … We were having trouble moving past that part to what we needed to do, which was *sell our services*."

> For those customers who *did* read the contract, negotiations would drag on and on.
>
> Kristin Kloberdanz, Honey, I Shrunk The Contract: How Plain English Is Helping GE Keep Its Business Humming, (GE.com 2017) (emphasis and extra paragraphing added).

GE's legal department decided to do something about it. Shawn Burton, the general counsel of that GE business unit, described his team's approach in a Harvard Business Review article.

• First, the legal team met with business people — who were enthusiastic about the prospect of simplifying their contracts — to identify business risks.

> See Chapter 19 for a systematic, step-by-step approach to identifying business risk.

• Then:

> Next the legal team started drawing up the contract, *beginning from scratch*.
>
> No templates. No "sample" clauses. **No use of or reference to the existing contracts.**
>
> We simply started typing on a blank sheet of paper, focusing only on the covered services and the risks we'd identified.
>
> Throughout the process, we applied our litmus test: *Can a high schooler understand this?*
>
> Shawn Burton, The Case for Plain-Language Contracts, Harv. Bus. Rev. Jan./Feb. 2018, archived at https://perma.cc/HW85-FGSA (emphasis and extra paragraphing added).

Burton provides several examples of streamlined provisions, such as the following revision:

*Before:*

> Customer shall *indemnify*, defend, and hold Company harmless from any and all claims, suits, actions, liabilities, damages and costs, including reasonable attorneys' fees and court costs, incurred by Company arising from or based upon (a) any actual or alleged infringement of any United States patents, copyright, or other intellectual property right of a third party, attributable to Customer's use of the licensed System with other software, hardware or configuration not either provided by Company or specified in Exhibit D.3, (b) any data, information, technology, system or other Confidential Information disclosed or made available by Customer to Company under this Agreement, (c) the use, operation, maintenance, repair, safety, regulatory compliance or performance of any aircraft owned, leased, operated, or maintained by Customer of [sic; or](d) any use, by Customer or

> by a third party to whom Customer has provided the information, of Customer's Flight Data, the System, or information generated by the System.

*After:*

> If an arbitrator finds that this contract was breached and losses were suffered because of that breach, the breaching party will *compensate* the non-breaching party for such losses or provide the remedies specified in Section 8 if Section 8 is breached.

(Emphasis added.)

**But here's the problem:** It can be dangerous to throw out an existing contract form and start over *unless you methodically list and address the principal business risks that the parties might encounter*, just as the GE Aviation unit did — and even then, *how do you know you've thought of all the possible risks?*

The language in the previous contracts presumably reflected past experience in how to handle the unusual- or oddball situations that can sometimes arise *and lead to disputes*. Throwing out the previous contracts might have lost that often-hard-won knowledge.

By analogy: The computer-programming world is quite familiar with this danger of losing knowledge gained from bitter experience. *Users of software expect the software to work well even in oddball situations*, especially those that the aviation world calls "pilot error," a.k.a. stupid human tricks (just as business clients expect contracts to accommodate unusual situations that might arise between the parties).

A much-cited 2000 essay, by highly-regarded software developer and entrepreneur Joel Spolsky, argues that throwing out the source code of an existing computer program and rewriting it from scratch is a terrible idea, one that has caused major headaches for companies such as Netscape (which developed one of the first widely-used Web browsers):

> The idea that new code is better than old is patently absurd. Old code has been *used*. It has been *tested*. Lots of bugs have been found, and they've been *fixed*. …
>
> Each of these bugs took weeks of real-world usage before they were found. …
>
> When you throw away code and start from scratch, you are throwing away all that knowledge. All those collected bug fixes. Years of programming work.

Joel Spolsky, Things You Should Never Do, Part I (JoelOnSoftware 2000) (emphasis in original). See also, e.g., Herb Caudill, Lessons from 6 software rewrite stories (Medium.com 2019).

The same could be true about contracts: If you throw out existing contract language and start from scratch, you risk losing years of accumulated knowledge of how the real world *can* work.

*There's another, safer approach:* Do what software developers refer to as "refactoring," namely cleaning up existing language, breaking it up into more-readable bullet points, as discussed in § 7.7.

## 3.4 Title: How will a title look *in a list*?

Imagine that you're looking at **a simple list** of *titles* of a particular company's contracts —

- Perhaps you're doing due diligence for a financing- or merger transaction and reviewing a long list of the target company's existing contracts.
- Perhaps you're doing a document review for a lawsuit or arbitration and looking at a similarly-long list of contracts.

Conider the following styles of title:

– **Title style 1** is simplicity itself, but it's not especially informative when seen as part of a list of agreement titles:

| |
|---|
| Agreement |

– **Title style 2** is fairly typical for contracts:

| |
|---|
| Agreement and Plan of Merger |

– **Title style 3** is more informative, but it might be overkill:

| |
|---|
| AGREEMENT AND PLAN OF MERGER<br>Among<br>UAL Corporation<br>Continental Airlines, Inc.<br>and<br>JT Merger Sub Inc.<br>Dated as of May 2, 2010 |

The example of style 3, incidentally, is from the 2010 merger agreement between United Airlines and Continental Airlines; see https://tinyurl.com/UAL-CAL-2010.

**Caution:** From style 3, be careful about including "Dated as of …" because the contract date might change *but the old date might be inadvertently left in the document* — especially if there's a rush to get to signature; this would violate the Don't Repeat Yourself principle and could lead to trouble, as discussed at § 8.8.)

Ultimately it's the drafter's choice.

## 3.5 Preamble: Front-load some useful information

While very few contracts are ever litigated, it takes very little time for a contract drafter to help out future trial counsel by properly drafting the preamble of the contract to include useful information. Here's an example for a hypothetical contract:

> **Purchase and Sale Agreement**
> for 2012 MacBook Air Computer
>
> This "**Agreement**" is between (i) Betty's Used Computers, LLC, a limited liability company organized under the laws of the State of Texas ("**Buyer**"), with its principal place of business and its initial address for notice at 1234 Main St, Houston, Texas 77002; and (ii) Sam Smith, an individual residing in Houston, Harris County, Texas, whose initial address for notice is 4604 Calhoun Rd, Houston, Texas 77004 ("**Seller**"). This Agreement is effective the last date written on the signature page.

Let's look at this preamble piece by piece: The included information is intended to make life easier on trial counsel if litigation should ever occur.

### 3.5.1 "This Agreement"

Many drafters would *repeat* the title of the agreement in all-caps in the preamble, thusly: "THIS PURCHASE AND SALE AGREEMENT (this "Agreement") …."

The author prefers the shorter approach shown in the quoted example above. That's because:

– It's doubtful that anyone would be confused about what "This 'Agreement'" refers to; and

– The shorter version reduces the risk that a future editor might (i) revise the title at the very top of the document but (ii) forget to change the title in the preamble. This is an example of the rule of thumb: **Don't Repeat Yourself**, or D.R.Y., discussed at Section 8.8: .

(In the second bullet point just above, notice how the first, long-ish sentence is broken up (i) with bullets, and (ii) with so-called "romanettes," that is, lower-case Roman numerals, to make the sentence easier for a contract reviewer to skim. This follows the maxim: *Serve the Reader*.)

### 3.5.2 Quoted, bold-faced defined terms

In the example above, note how the preamble defines the terms *Agreement*, *Buyer*, and *Seller*: These defined terms are not only in bold-faced type: they're also surrounded by quotation marks and parentheses. This helps to make the defined terms stand out to a reader who is skimming the document.

When drafting "in-line" defined terms like this, it's a good idea to highlight them in this way; this makes it easier for a reader to spot a desired definition quickly when scanning the document to find it.

Imagine the reader running across a reference to some other defined term and starting to flip through the document, wondering to herself, "OK, what does 'Buyer' mean again?"

NOTE: If you also have a separate definitions section for defined terms, it's a good idea for that definitions section to include cross-references to the in-line definitions as well, so that the definitions section serves as a master glossary of all defined terms in the agreement.

See also § 4 for more discussion of defined terms.

### 3.5.3 Specific terms: "Buyer" and "Seller"

This preamble uses the defined terms *Buyer* and *Seller* instead of the parties' names, Betty and Sam, because:

- Doing this can make it easier on future readers … such as a judge … to keep track of who's who.
- Doing this also makes it easier for the drafter to re-use the document for another deal by just changing the names at the beginning.

Sure, global search-and-replace can work, but it's often over-inclusive. For example: Automatically changing all instances of *Sam* to *Sally* might result in the word *samples* being changed to *sallyples*.

### 3.5.4 Agreement "between (*not* "by and between") the parties

Our preamble says that the contract is *between* the parties — not *by and between* the parties, and not *among* them.

True, many contracts say "by and between" instead of just "between." The former, though, sounds like legalese, and the latter works just as well.

For contracts with multiple parties, some drafters will write *among* instead of *between*; that's fine, but *between* also works.

### 3.5.5 Stating details about the parties (to help in litigation)

Our preamble provides certain details about the parties,such as where Betty's Used Computers, LLC is organized (Texas) and Sam's county of residence.

When a party to a contract is a corporation, LLC, or other organization, it's an excellent idea for the preamble to state both:

- the type of organization, in this case "a limited liability company"; and
- the jurisdiction under whose laws the organization was formed, in this case "organized under the laws of the State of Texas."

Doing this has several benefits:

– It reduces the chance of confusion in case the same company name is used by different organizations in different jurisdictions … imagine how many "Acme Corporations" or "AAA Dry Cleaning" there must be in various states.

– It helps to nail down at least one jurisdiction where the named party is subject to personal jurisdiction and venue, saving future trial counsel the trouble of proving it up; and

– It helps to establish whether U.S. federal courts have diversity jurisdiction (a U.S. concept that might or might not be applicable).

A shorter version is also acceptable: "Betty's Used Computers, LLC, a Texas limited liability company …."

Including the jurisdiction of organization can simplify a litigator's task of "proving up" the necessary facts: If a contract signed by ABC Corporation recites that ABC is a Delaware corporation, for example, an opposing party generally won't have to prove that fact, because ABC will usually be deemed to have "acknowledged" it, that is, conceded the point in advance.

This particular hypothetical agreement is set up to be between a limited liability company, or "LLC," and an individual; in that way, the signature blocks will illustrate how organizational signature blocks should be done.

### 3.5.6 Principal place of business (or residence) and initial address

Note how the preamble above states some geographical information about the parties:

– Principal place of business: Stating Betty's principal place of business helps trial counsel avoid having to prove up the court's personal jurisdiction. For example, a Delaware corporation whose principal place of business was in Houston would almost certainly be subject to suit in Houston.

– Residence: Likewise, if a party to a contract is an individual, then stating the individual's residence helps to establish personal jurisdiction over him or her and the proper venue for a lawsuit against the individual.

– County: Stating the county of an individual's residence might be important if the city of residence extends into multiple counties.

For example, Houston is the county seat of Harris County, but just because Sam lives in Houston doesn't automatically mean that he can be sued in the county's courts in downtown Houston. That's because Houston's city limits extend into Fort Bend County to the southwest and Montgomery County to the north. Sam might live in the City of Houston but in one of those other counties, and so he might have to be sued in his home county and not in Harris County.

– Addresses for notice: It's convenient to put the parties' initial addresses for notice in the preamble. That way, a later reader won't need to go paging through the agreement looking for the notice provision. Doing this also makes it easy for contract reviewer(s) to verify that the information is correct.

### 3.5.7 Stating the effective date in the preamble

The above preamble affirmatively states the effective date; that's usually unnecessary (and it's not the author's preference) unless the contract is to be effective *as of* a specified date.

(Many drafters like to include the effective date anyway; *it's normally not worth changing* if someone else has drafted it this way.)

The author prefers the last-date-signed approach: "This Agreement is effective the last date written on the signature page."

Here's a different version of that approach: "This 'Agreement' is made, effective the last date signed as written below, between …."

In reviewing others' contract drafts, you're likely to see some less-good possibilities, such as:

– "This Agreement is *made* December 31, 20XX, between …."

– "This Agreement is *dated* December 31, 20XX, between …."

Either of these can be problematic because the stated date might turn out to be inaccurate, depending on when the parties actually sign the contract.

**Caution:** Never backdate a contract for deceptive purposes, e.g., to be able to book a sale in an earlier period — as discussed at § 3.10, that practice has sent more than one corporate executive to prison, including at least one general counsel.

On the other hand, it might be just fine to state that a contract is effective as of a different date. EXAMPLE: Alice discloses confidential information to Bob af-

ter Bob first orally agrees to keep the information confidential; they agree to have the lawyers put together a written confidentiality agreement. That written agreement might state that it is effective as of the date of Alice's oral disclosure.

The following might work if it's for non-deceptive purposes: "This Agreement is entered into, effective December 31, 20XX, by …."

(Alice and Bob would not want to backdate their actual signatures, though.)

### 3.5.8 Include the parties' *affiliates* as "parties"? (Probably not.)

Some agreements, in identifying the parties to the agreement on the front page, state that the parties are, say, *ABC Corporation and its Affiliates*. That's generally a bad idea unless each such affiliate actually signs the agreement as a party and therefore commits on its own to the contractual obligations.

The much-better practice is to state clearly the specific rights and obligations that (some or all) affiliates have under the contract. This is sometimes done in "master" agreements negotiated by a party on behalf of itself and its affiliates.

For example, consider a negotiated master purchase agreement between a customer and a provider. The master agreement might require the provider to accept purchase orders under the master agreement from the customer's affiliates as well as from the customer itself, so that the customer's affiliates can take advantage of the pre-negotiated pricing and terms.

**Caution:** An affiliate of a contracting party might be bound by the contract if (i) the contracting party — or the individual signing the contract on behalf of that party — happens to "control" the affiliate, and (ii) the contract states that the contract is to benefit the affiliate. That was the result in a Delaware case where:

- the contract stated that a strategic alliance was being created for the contracting party *and its affiliates*, and
- the contract was signed by the president of the contracting party, *who was also the sole managing member of the affiliate*.

The court held that the affiliate was bound by — and had violated — certain restrictions in the contract.

> See Medicalgorithmics S.A. v. AMI Monitoring, Inc., No. 10948-CB, slip op. at 3, 52-53, text accompanying n.219 (Del. Ch. Aug. 18, 2016); see also, e.g., Mark Anderson, Don't Make Affiliates parties to the agreement (2014); Ken Adams, Having a Parent Company Enter Into a Contract "On Behalf" of an Affiliate (2008).

### 3.5.9 Is country-specific information required?

Some countries require contracts to include specific identifying information about the parties, e.g., the registered office and the company ID number. This is worth checking for contracts with parties or operations in such countries.

> See Ken Adams, When the Law Says What Party-Specific Information You Have to Include in the Introductory Clause (AdamsDrafting.com 2016); Ken Adams, Using Company Numbers in the Introductory Clause (AdamsDrafting.com 2007) — the comments discuss similar requirements in various countries.

### 3.5.10 Naming the "wrong" party can screw up contract enforcement

Be sure you're naming the correct party as "the other side" — or consider negotiating a guaranty from a solvent affiliate.

Failing to name the correct corporate entity could leave your client holding the bag. This seems to have happened in a Seventh Circuit case:

– The named party in the contract had essentially no assets (the assets were all owned by the named party's parent company).

– The other named party sued the parent company for breach of the contract.

The appellate court affirmed summary judgment in favor of the parent company, saying: "It goes without saying that a contract cannot bind a nonparty. … If appellant is entitled to damages for breach of contract, [it cannot] recover them in a suit against appellee because appellee was not a party to the contract."

> Northbound Group, Inc. v. Norvax, Inc., 795 F.3d 647, 650-51 (7th Cir. 2015) (cleaned up and reformatted).

### 3.5.11 Does each party have *capacity to contract*?

Depending on the law of the jurisdiction, an unincorporated association or trust might not be legally capable of entering into contracts.

> See generally, e.g., Ken Adams, Can a Trust Enter Into a Contract? (AdamsDrafting.com 2014).

If a contract is purportedly entered into by a party that doesn't have the legal capacity to do so, then conceivably the individual who signed the contract on behalf of that party might be personally liable for the party's obligations.

## 3.6 **Background of the Agreement: No "Whereas"!**

### 3.6.1 Style tip: Delete "Witnesseth" and "Whereas"

*Note: Like all purely-style tips, this particular style tip isn't worth making a big deal about if you're reviewing a draft prepared by The Other Side, see Section 6.2: . And if your supervising partner has a preference, then do it that way, see Section 6.1: .*

Modern contract drafters avoid using the archaic words "WITNESSETH" and "Whereas." For an example of what *not* to do, see the the example below, from a routine commercial real-estate purchase agreement.

(Don't bother reading the text below, just get a sense of how it looks.)

> THIS REAL ESTATE PURCHASE AND SALE AGREEMENT (this "Agreement") is made and entered into by and between WIRE WAY, LLC, a Texas limited liability company ("Seller"), and RCI HOLDINGS, INC., a Texas corporation ("Purchaser"), pursuant to the terms and conditions set forth herein.
>
> W I T N E S S E T H:
>
> WHEREAS, Seller is the owner of a certain real property consisting of approximately 4.637± acres of land, together with all rights, (excepting for mineral rights as set forth below) , title and interests of Seller in and to any and all improvements and appurtenances exclusively belonging or pertaining thereto (the "Property") located at 10557 Wire Way, Dallas (the "City"), Dallas County, Texas, which Property is more particularly described on Exhibit A attached hereto and incorporated herein by reference; and
>
> WHEREAS, contemporaneously with the execution of this Agreement, North by East Entertainment, Ltd., a Texas limited partnership ("North by East"), is entering into an agreement with RCI Entertainment (Northwest Highway), Inc., a Texas corporation ("RCI Entertainment"), a wholly owned subsidiary of Rick's Cabaret International, Inc., a Texas corporation ("Rick's") for the sale and purchase of the assets of the business more commonly known as "Platinum Club II" that operates from and at the Property ("Asset Purchase Agreement"); and
>
> WHEREAS, subject to and simultaneously with the closing of the Asset Purchase Agreement, Seller will enter into a lease with RCI Entertainment, as Tenant, for the Property, dated to be effective as of the closing date, as defined in the Asset Purchase Agreement (the "Lease") attached hereto as Exhibit B and incorporated herein by reference; and
>
> WHEREAS, subject to the closing of the Asset Purchase Agreement, the execution and acceptance by Seller of the Lease, and pursuant to the terms and provisions contained herein, Seller desires to sell and convey to Purchaser and Purchaser desires to purchase the Property.
>
> NOW, THEREFORE, for and in consideration of the premises and mutual covenants and conditions contained herein, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree **as follows:**

This is pretty hard to read, no?

The above example has other problems, in addition to its use of archaic "Whereas" clauses: Because of the "as follows" language at the end of the last paragraph quoted above, it can be argued that *the parties did not agree* to the Whereas clauses.

> For more discussion of this point, see Section 3.6.3: .

### 3.6.2 Use the "Background" section to set the stage

Instead of "Recitals" — or worse yet, W H E R E A S clauses — describe the background in a (*numbered*) "Background" section of the contract.

As a general proposition, the Background section should just tell the story: Explain to the future reader, in simple terms — with short sentences and paragraphs — just what the parties are doing, so as to help future readers get up to speed more quickly.

As a horror story, consider the WHEREAS example quoted in Section 3.6.1: above: Good luck trying to figure out what's really going on — there *seems* to be some kind of business roll-up going on, with a sale and leaseback of real estate and maybe other assets, but that's not at all clear. Now imagine that you're a judge or a judge's law clerk who's trying to puzzle out the story. Worse: Imagine that you're a juror trying to make sense of this transaction.

Somewhat better is the following excerpt is from a highly publicized stock purchase agreement in the tech industry, rewritten into background-section form below:

> See Stock Purchase Agreement by and among Yahoo! Inc. and Verizon Communications Inc. dated as of July 23, 2016, https://tinyurl.com/VerizonYahooAgreement

*Before:*

> WHEREAS, concurrently with the execution and delivery of this Agreement, Seller and Yahoo Holdings, Inc., a Delaware corporation (the "Company"), are entering into a Reorganization Agreement substantially in the form attached hereto as Exhibit A (the "Reorganization Agreement"), pursuant to which Seller and the Company will complete the Reorganization Transactions at or prior to the Closing;

*After:*

> 1. **Background**
>
> 1.01 At the same time as this Agreement is being signed, Seller and Yahoo Holdings, Inc., a Delaware corporation (the "Company"), are entering into a Reorganization Agreement.
>
> 1.02 Under the Reorganization Agreement, Seller and the Company are to complete certain "Reorganization Transactions" at or prior to the Closing.

> 1.03 The Reorganization Agreement is in substantially the form attached to this Agreement as Exhibit A.

Notice the shorter, single-topic paragraphs, discussed in more detail at Section 7.5: .

### 3.6.3 A contract's background statements *might* be binding

Different jurisdictions might treat background statements differently. For example:

- California Evidence Code § 622 provides: "*The facts recited in a written instrument are conclusively presumed to be true* as between the parties thereto, or their successors in interest; but this rule does not apply to the recital of a consideration." (Emphasis added.)
- But: "Contracts often contain recitals: provisions that do not make binding promises but *merely recite background information about factual context* or the parties' intentions. Maryland law recognizes the general principle that *such recitals are not binding* and, while they may aid the court in interpreting the contract's operative terms, cannot displace or supplement operative terms that are clear."

> Sprint Nextel Corp. v. Wireless Buybacks Holdings, LLC, 938 F.3d 113, 127 (4th Cir. 2019) (vacating and remanding partial summary judgment) (emphasis added).

### 3.6.4 A statement of *one party's* intent might not be binding

A naked statement of one party's subjective intent in entering into the contract might not suffice to be binding on another party. That happened in a case involving Sprint, the cell-phone service provider:

- Sprint offered "upgraded" phones to its customers at steep discounts when customers renewed their contracts — the discounts were so steep that the customers paid less than what the phones would bring on the used-phone market.
- Another company, Wireless Buybacks, bought upgraded phones from Sprint customers and resold them at a profit.
- Sprint sued Wireless Buybacks for tortious interference with Sprint's contracts with its customers.
- Sprint claimed that its contract prohibited resale because it said in part: "Our rate plans, customer devices, services and features *are not for resale* and are intended for reasonable and non-continuous use by a person using a device on Sprint's networks." (Emphasis added.)

The trial court found that this language unambiguously barred resale; the court granted partial summary judgment for Sprint. On appeal, however, the Fourth

Circuit held that the contract language "is *a background statement of intent*, not an enforceable promise not to resell Sprint phones."

> Sprint Nextel Corp. v. Wireless Buybacks Holdings, LLC, 938 F.3d 113, 127 (4th Cir. 2019) (vacating and remanding partial summary judgment; emphasis added).

### 3.6.5 Keep parties' rights and obligations out of the Background

Inexperienced contract drafters will sometimes put specific rights and/or obligations in a Background section. That's a bad idea for the reasons discussed above.

*Example 1:* One of the author's students once wrote *in the Background section*: "For all purposes, the Data is owned by Client and is provided to Contractor for completion of services under this Agreement." DCT COMMENT: This shouldn't go into the Background section, but instead in a substantive section, for example in a section about ownership of intellectual property.

*Example 2:* Another student wrote: "Client will pay Contractor as stated in this Agreement." DCT COMMENT: This shouldn't be in the Background section, because the payment provisions would (or at least should) speak for themselves — moreover, readers would naturally *assume* that Client would pay Contractor, so there was no need to include that fact *in the Background section*.

*Example 3:* Still another student wrote: "The parties have agreed that Client will compensate Provider with a flat monthly fee of $20,000 for up to 200 staff hours of work per month, with additional work hours being billed at $150 per hour." DCT COMMENT: This would work *if* the Background section was the only place that the specific compensation details were discussed, so as not to violate the D.R.Y. (Don't Repeat Yourself) guideline discussed at Section 8.8: .

*Example 4:* A student wrote: "Client and Service Provider enter into the Agreement for the term of one year from the effective date of the Agreement." DCT COMMENT: This is another item that would go into a substantive provision further down in the contract, not into the Background section.

### 3.6.6 Skim: Some other student "background" efforts

*Note to students: This section will give you an idea of some minor errors that can arise in drafting a background section.*

1. A student used "WHEREAS" several times. DCT COMMENT: That's OK if the partner wants it, but it's archaic.

2. A student described one of the parties, "Mary," as an "expert." DCT COMMENT: If I were Mary, I wouldn't want that — the other side might argue later that Mary *had held herself* out as an expert but she really wasn't.

3. Several students wrote variations on, e.g., "Gigunda desires for MathWhiz to analyze data, and MathWhiz desires to do so." DCT COMMENT: I wouldn't phrase it that way; instead, I'd let the rest of the contract speak for itself. (And in any case, the parties' *subjective* desires don't enter into contract interpretation except in cases of a lack of meeting of the minds or mutual mistake.)

## 3.7 Signature blocks

*See also the Tango Terms "signatures" provisions.*

Contracts generally get "signed" in some fashion; under U.S. law, contract signatures can take a variety of forms, as discussed in the commentary below.

**Note:** As first-year law students learn, a so-called unilateral contract can be formed *without* signatures from both parties if an unrevoked, otherwise-eligible offer is accepted by performance.

> *Example:* Alice posts handbills on light poles, offering a $100 reward for the return of her missing cat, "Fluffy." If Bob finds Fluffy and returns her to Alice, then Bob's performance constitutes completion of the contract and obligates Alice to pay Bob the reward money.

### 3.7.1 Precede with a concluding paragraph? (No.)

Some conventional contracts, with the signature blocks at the end of the contract, precede the signature blocks with a concluding paragraph such as the following:

> ✘ To evidence the parties' agreement to this Agreement, each party has executed and delivered it on the date indicated under that party's signature.

Such paragraphs are unnecessary; here's why:

- First, that kind of concluding paragraph is overkill. There are other ways of proving up that The Other Side in fact delivered a signed contract to you — for starters, the fact that you have a copy in your possession that bears (what at least purports to be) The Other Side's signature.
- Second, at the instant of signature, a *past-tense* statement that each party "has delivered" the signed contract is technically inaccurate — and even more so at the moment when the *first* signer affixes his (or her) signature.

But if you see this kind of language in a draft prepared by the other side, don't change it (as discussed in § 6.2).

### 3.7.2 Signature dates

Author's note: I usually draft signature blocks with blanks for the signers to *hand-write* the date signed; see the example shown at Section 3.7.8: .

It's usually better **not** to type in the expected date of signature. That's because one or more parties might sign on a different date; moreover, if signature is delayed, a pre-typed signature date could help an unscrupulous signer to passively — but still fraudulently — backdate the contract (see Section 3.10: ).

> ✓ "Signed on the dates indicated below"
>
> ✘ "Signed December 12, 20xx"

For similar reasons, it's better **not** to type a purported date in the preamble:

> ✓ "This Agreement is made effective the last date signed as written in the signature blocks …."
>
> ✘ "This Agreement is made December 31, 20XX, between …."

Relatedly: I also try to avoid leaving a blank space in the preamble for the effective date:

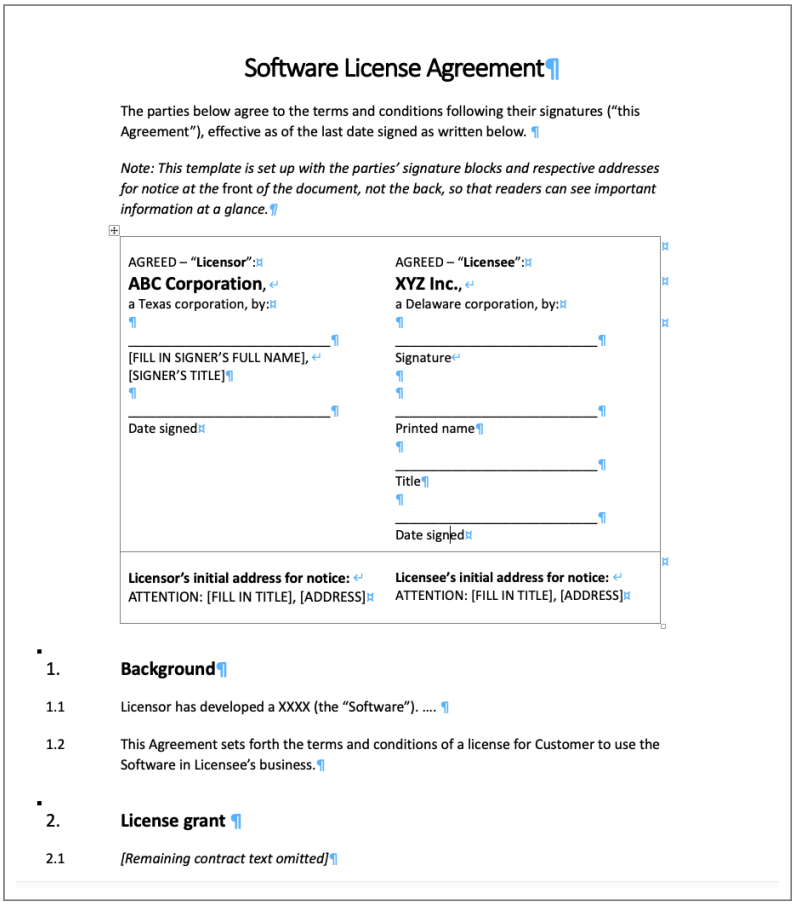
> ✘ "This Agreement is made December ___, 20XX, between …."

That's because the parties might well neglect to fill in the date, meaning that the contract gets signed with the blank space still there.

This is an example of the **R.O.O.F.** principle: Root Out Opportunities for [Foul]-ups!

### 3.7.3 Corporate- and LLC signature blocks

The signature blocks shown at Section 3.7.8: (repeated below) are for different types of organization — on the left is a signature block for when the signer's name and title are known; on the right, when not:



Software License Agreement¶

The parties below agree to the terms and conditions following their signatures ("this Agreement"), effective as of the last date signed as written below. ¶

*Note: This template is set up with the parties' signature blocks and respective addresses for notice at the front of the document, not the back, so that readers can see important information at a glance.¶*

| AGREED – "**Licensor**":<br>**ABC Corporation**,<br>a Texas corporation, by:<br>¶<br>_____¶<br>[FILL IN SIGNER'S FULL NAME],<br>[SIGNER'S TITLE]¶<br>¶<br>_____¶<br>Date signed | AGREED – "**Licensee**":<br>**XYZ Inc.,**<br>a Delaware corporation, by:<br>¶<br>_____¶<br>Signature<br>¶<br>¶<br>_____¶<br>Printed name¶<br>¶<br>_____¶<br>Title¶<br>¶<br>_____¶<br>Date signed |
|---|---|
| **Licensor's initial address for notice:**<br>ATTENTION: [FILL IN TITLE], [ADDRESS] | **Licensee's initial address for notice:**<br>ATTENTION: [FILL IN TITLE], [ADDRESS] |

1. **Background**¶

1.1 Licensor has developed a XXXX (the "Software"). .... ¶

1.2 This Agreement sets forth the terms and conditions of a license for Customer to use the Software in Licensee's business.¶

2. **License grant** ¶

2.1 *[Remaining contract text omitted]*¶

• Note that each of those signature blocks starts out with the word "AGREED:" in all-caps and followed by a colon — possibly including the abbreviation for the signing party, shown as "Licensor" and "Licensee" above.

• Each organization's signature block lists the organization's **full legal name** followed by the word "by" and a colon.

• Date signed: Each signer should **hand-write** the date signed, for reasons discussed at the commentary to Section 3.10: .

• Printed name blank line: In signature blocks with blank lines, be sure to include a space for the printed name, because the signatures of some people are difficult to read.

• Title: In any signature block for an organization, be sure to include the signer's title, to establish a basis for concluding that the signer has authority to sign on behalf of the organization; if the employee's title includes the word "president," "vice president," "manager," or "director" *in the relevant area of the business*, that might be enough to establish the employee's apparent authority.

See § 3.11.4 (But *apparent* authority can save the day).

### 3.7.4 Signature blocks for individuals

If an individual is a party to the contract, the signature block can be just the individual's name under an underscored blank space.

Example:

> AGREED:
>
> ……
> Jane Doe
>
> ……
> Date signed

But you might not know the individual signer's name in advance, in which case you could use the following format:

> AGREED:
>
> ……
> Signature
>
> ……
> Printed name
>
> ……
> Date signed

### 3.7.5 Special case: Signature block for a limited partnership

In many U.S. jurisdictions, a limited partnership might be able to act only through a general partner, in which case a signature block for the limited partnership might need to include the general partner's name. And the general partner of a limited partnership might very well be a corporation or LLC; in that case, the signature block would be something like the following:

> AGREED: ABC LP, by:
> ABC Inc., a Texas corporation,
> general partner, by:
>
> ……
> Ronald R. Roe,
> Executive Vice President
>
> ……
> Date signed

On the other hand, in some jurisdictions, a limited partnership might be able to act through its own officers; for example, Delaware's limited-partnership statute gives general partners the power "to delegate to agents, officers and employees of the general partner or the limited partnership …."

> Del. Code § 17-403(c) (emphasis added).

In such cases, the signature block of a limited partnership might look like the signature block of a corporation or LLC, above.

**Caution:** A *limited* partner who, acting in that capacity, signs a contract on behalf of the limited partnership could be exposing herself to claims that she should be held jointly and severally liable as a *general* partner. (Of course, some general partners also hold limited-partnership investment interests and thus are limited partners in addition to being general partners.)

### 3.7.6 Include company titles for client relations, too

Including company titles is highly advisable to help establish apparent authority, as discussed above. But there's another reason to do so: If your client is a company, then some individual human, typically an officer or manager of the company, will be signing on behalf of the client. In that situation, the client's signature block in the contract should normally state that it's *the company* that is signing the contract, *not* the individual human in his- or her personal capacity — with the attendant personal liability.

To be sure, if your client is the company and not the human signer, then technically you're under no professional obligation to make sure that the human signer is protected from *personal* liability. But it's normally not a conflict of interest for you to simultaneously look out for the human signer as well as for the company; doing that can give the human signer a warm fuzzy feeling about you, which is no bad thing.

> *Caution:* A lawyer might find herself dealing with an employee of a client company in a situation where the interests of the employee and the company diverge or even conflict. One example might be an investigation of possible criminal conduct such as deceptive backdating of a contract (discussed at Section 3.10: ). In circumstances such as those, the lawyer should consider whether she should affirmatively advise the employee, *preferably in writing*, that she's not the employee's lawyer — conceivably, the lawyer might even have an ethical obligation to do so.

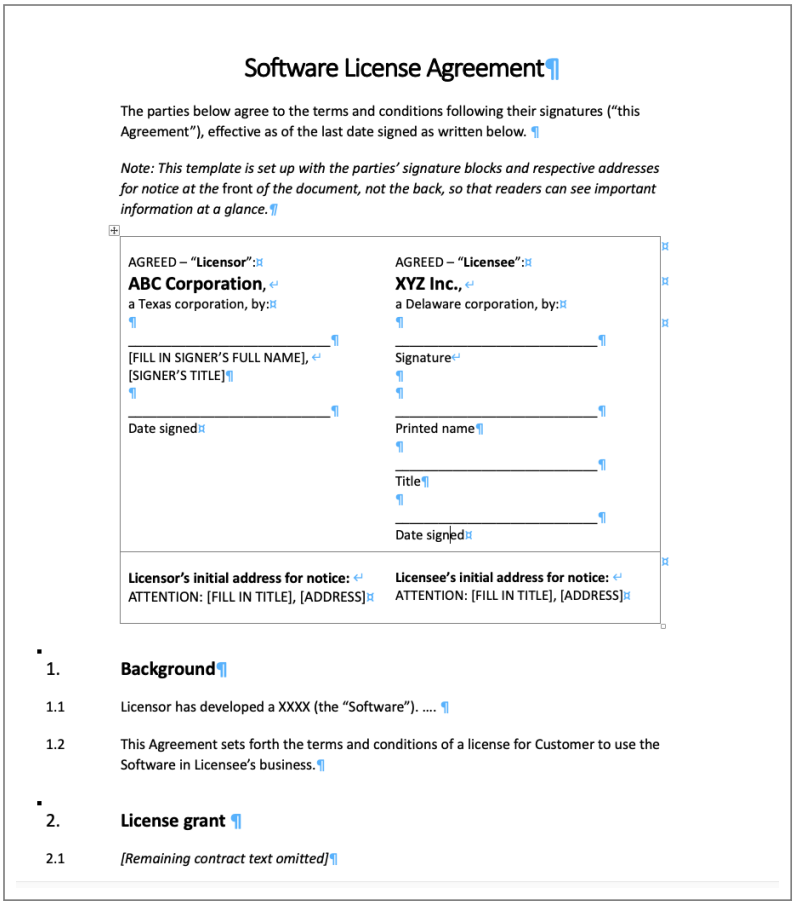
### 3.7.7 Try to keep signature blocks on the same page

The author prefers to keep all of the text of a signature block together on the same page (which might or might have other text on it). That looks more professional than having a signature block spill over from one page onto the next. This can be done using Microsoft Word's paragraph formatting option, "Keep with Next."

### 3.7.8 Put the signature blocks up front?

In the example signature blocks immediately below, you'll see that the signature blocks are in a table *at the front* of the agreement, along with the parties' respective initial addresses for notice. This make the agreement more reader-friendly:

- You can see at a glance whether you're looking at the *signed* agreement; and
- To find a party's (initial) address for notice, you don't need to go rummaging through the document



Software License Agreement¶

The parties below agree to the terms and conditions following their signatures ("this Agreement"), effective as of the last date signed as written below. ¶

*Note: This template is set up with the parties' signature blocks and respective addresses for notice at the front of the document, not the back, so that readers can see important information at a glance.¶*

| AGREED – "**Licensor**":<br>**ABC Corporation**,<br>a Texas corporation, by:<br>¶<br>_____<br>[FILL IN SIGNER'S FULL NAME],<br>[SIGNER'S TITLE]<br>¶<br>_____<br>Date signed | AGREED – "**Licensee**":<br>**XYZ Inc.,**<br>a Delaware corporation, by:<br>¶<br>_____<br>Signature<br>¶<br>¶<br>_____<br>Printed name<br>¶<br>_____<br>Title<br>¶<br>_____<br>Date signed |
|---|---|
| **Licensor's initial address for notice:**<br>ATTENTION: [FILL IN TITLE], [ADDRESS] | **Licensee's initial address for notice:**<br>ATTENTION: [FILL IN TITLE], [ADDRESS] |

1. **Background**¶

1.1 Licensor has developed a XXXX (the "Software"). .... ¶

1.2 This Agreement sets forth the terms and conditions of a license for Customer to use the Software in Licensee's business.¶

2. **License grant** ¶

2.1 *[Remaining contract text omitted]*¶

### 3.7.9 Should *counsel* sign for clients? (Usually: No.)

A lawyer for a party entering into a contract normally won't want to be the one to sign the contract on behalf of her client, because:

FIRST: Signing a contract for a client could later raise questions whether, in the negotiations leading up to the contract, the lawyer was acting as a *lawyer* or as a *business person*. This could be an important distinction: in the latter case, the lawyer's private communications with her client might not be protect-

ed by the attorney-client privilege and thus might be subject to discovery by third parties (which is never a good look, in terms of client relations).

SECOND: From a client-relations perspective, if the contract later "goes south," the lawyer won't want her signature on the contract. The general counsel of pharmaceutical giant Novartis was painfully reminded of this after *he* signed a consulting contract with Michael Cohen, formerly the personal lawyer for Donald Trump; as a result, the GC lost his job when the contract attracted unwanted publicity to the company:

> Novartis's top lawyer is to retire from the company over payments made by the pharmaceutical giant to President Trump's personal lawyer Michael D. Cohen, the Swiss drug maker said on Wednesday. * * *
>
> "Although the contract was legally in order, it was an error," Mr. Ehrat said. "*As a cosignatory with our former C.E.O.*, I take personal responsibility to bring the public debate on this matter to an end."

Prashant S. Rao and Katie Thomas, Novartis's Top Lawyer is Out Amid Furor Over Payments to Michael Cohen (NYTimes.com May 16, 2018) (emphasis added).

## 3.8 Signature mechanics

### 3.8.1 Signing separate copies

It's common for each party to want its own, fully-signed "original" of a contract; the above language provides for that.

If hard copies are going to be *manually* signed, see Section 3.7: for suggestions on how to draft the signature blocks to avoid possible challenges later.

### 3.8.2 Exchanging signed signature pages only

Nowadays it's quite common for the parties, in different locations, to sign separate copies of a contract and for each party to email the other party a PDF of its signed signature page only; the above language supports this practice.

### 3.8.3 Be sure all signed pages are "final"

It's very common for parties in separate locations to manually sign separate copies of a paper contracts and then to email a PDF image (or, old-school, to FAX) just their signed signature pages to each other.

**Caution:** If only the signed signature pages of a contract will be exchanged, the parties should make sure it's clear that everyone is signing the same version of the document, otherwise the contract might not be binding. *Not* doing this proved fatal to a party's case in Delaware, where the parties had ex-

changed signature pages, but the pages were from *two different drafts*, only one of which included the crucial provision (a noncompetition covenant). The chancery court held that there had been no meeting of the minds and thus there was not a valid contract.

> See Kotler v. Shipman Assoc., LLC, No. 2017-0457-JRS (Del. Ch. Aug. 27, 2019) (rendering judgment for company).

**Pro tip:** For that reason, a signature page should preferably be tied to a specific version of the Contract by including, *on each page* of the Contract, a running header or -footer that identifies the document and its version.

*Example:* In a draft confidentiality agreement between ABC Corporation and XYZ LLC, a running header could read "ABC-XYZ Confid. Agrmt. ver. 2019-03-01 15:00 CST" — where the date and time at the end are *hand-typed*, and not in an automatically-updating "field." (Including such a running header can also help avoid confusion when the parties are discussing a draft of the agreement, by allowing the parties to make sure that everyone is looking at the same draft.)

### 3.8.4 Pro tip: Combine all signed pages?

It's a good idea to combine • the PDF of the unsigned agreement, and • the PDFs of the signed signature pages, into a single "record copy" PDF.

Then: Email the combined, record-copy PDF to all concerned: The email will serve as a paper trail to help establish the authenticity of the record copy.

## 3.9 Electronic signatures

Electronic signatures are increasingly popular; in recent years the present author has seen fewer and fewer contracts drafted for wet-ink signatures.

### 3.9.1 Legal basis for electronic signatures

U.S. law explicitly law supports the use of electronic signatures, and American courts now routinely honor electronic "signatures" (which are now common in England and Wales as well).

> See generally the federal Electronic Signatures in Global and National Commerce Act (*"E-SIGN Act"*), 15 U.S.C. § 7001 et seq., which provides in part (subject to certain stated exceptions) that, for transactions "in or affecting interstate or foreign commerce," electronic contracts and electronic signatures may not be denied legal effect solely because they are in electronic form. • At the U.S. state level, 47 states, the District of Columbia, and Puerto Rico, and the U.S. Virgin Islands have adopted the Uniform Electronic Transactions Act ("*UETA*"). • The remaining three states — Illinois, New York, and Washington — have adopted their own statutes validating electronic

signatures. See, e.g., Naldi v. Grundberg, 80 A.D.3d 1, 908 N.Y.S.2d 639 (N.Y. App. Div. 2010); [UK] Law Commission, Electronic Execution of Documents (2019), at https://perma.cc/UCQ7-U94M.

### 3.9.2 Caution: Parties must agree to electronic signatures

Section 5(b) of the UETA states that:

> This [Act] applies only to transactions between parties **each of which has agreed** to conduct transactions by electronic means. Whether the parties agree to conduct a transaction by electronic means is determined from the context and surrounding circumstances, including the parties' conduct.

(Square brackets in original, emphasis added.) This section is intended to "check the box" that the parties have indeed agreed to conduct transactions electronically.

### 3.9.3 Caution: State law might limit electronic signatures

The following language is part of the California version but not of the UETA:

> (b) … Except for a separate and optional agreement the primary purpose of which is to authorize a transaction to be conducted by electronic means, an agreement to conduct a transaction by electronic means **may not be contained** in a standard form contract that is **not** an electronic record.
>
> An agreement in such a standard form contract may **not** be conditioned upon an agreement to conduct transactions by electronic means.
>
> An agreement to conduct a transaction by electronic means may not be inferred solely from the fact that a party has used electronic means to pay an account or register a purchase or warranty.
>
> This subdivision **may not** be varied by agreement.

Cal. Civ. Code § 1633.5(b) (emphasis and extra paragraphing added).

**And:** Under California law, a car dealer apparently must still obtain a manual contract signature from a car buyer.

See Cal. Civ. Code § 1633.3(c) (various carve-outs from authorization of electronic signatures) and Cal. Veh. Code § 11736(a) (requiring signed agreement with car-buying consumer).

### 3.9.4 Pro tip: Be able to *prove up* electronic signatures

A California appeals court affirmed denial of an employer's petition to compel arbitration of a wage-and-hour claim by one of its employees. The arbitration agreement had an electronic signature, but according to the court, the employer had not sufficiently proved that the purported electronic signature on the arbitration agreement was in fact that of the employee.

> Ruiz v. Moss Bros. Auto Group, Inc., 181 Cal. Rptr.3d 781, 232 Cal. App. 4th 836, 844-45 (Cal. App. 2014).

The California court seems to have offered a road map for contract professionals about what would suffice to prove up an electronic signature in litigation:

> *[The employer's business manager]* Main never explained how Ruiz's printed electronic signature, or the date and time printed next to the signature, came to be placed on the 2011 agreement.
>
> More specifically, Main did not explain how she ascertained that the electronic signature on the 2011 agreement was "the act of" Ruiz. This left a critical gap in the evidence supporting the petition.
>
> Indeed, Main did not explain[:]
>
> • that an electronic signature in the name of "Ernesto Zamora Ruiz" could only have been placed on the 2011 agreement (i.e., on the Employee Acknowledgement form) by a person using Ruiz's "unique login ID and password";
>
> • that the date and time printed next to the electronic signature indicated the date and time the electronic signature was made;
>
> • that all Moss Bros. employees were required to use their unique login ID and password when they logged into the HR system and signed electronic forms and agreements;
>
> • and the electronic signature on the 2011 agreement was, therefore, apparently made by Ruiz on September 21, 2011, at 11:47 a.m.
>
> Rather than offer this or any other explanation of how she inferred the electronic signature on the 2011 agreement was the act of Ruiz, Main only offered her unsupported assertion that Ruiz was the person who electronically signed the 2011 agreement.
>
> > *Id.*, 232 Cal. App.4th at 844 (extra paragraphing and bullets added, citation omitted).

### 3.9.5 Additional resources

See also: • Section 3.7: for suggestions on how to draft signature blocks, with examples, as well as • Section 3.11.4: for cautions about whether an individual signer has authority to sign for a party that is a corporation or other organization, and • Section 3.9.1: concerning electronic signatures.

See generally: • the definitions of *signed* and *writing* in UCC §1-201(37) and 1-201(43); the definition of *signature* in the Texas Business Organizations Code § 1.002(87); "… a writing has been signed by a person when the writing includes, bears, or incorporates the person's signature. A transmission or reproduction of a writing signed by a person is considered signed by that person …." *Id.* § 1.007; and • the Model Business Corporation Act § 1.40 (rev. 2016).

## 3.10 Backdating a contract - danger!

### 3.10.1 Backdating *can* be OK

Signing a contract that is "backdated" to be effective as of an earlier date might well be OK. (This is referred to in Latin legalese as *nunc pro tunc*, or "now for then.") The contract itself should make it clear that parties are doing this, to help forestall later accusations that one or both parties had an intent to deceive.

*Example:* Suppose that Alice discloses confidential information to Bob, a potential business partner, after Bob first orally agrees to keep the information confidential. Alice might well want to enter into a written nondisclosure agreement with Bob that states the agreement and its confidentiality obligations are effective as of the date of Alice's oral disclosure.

### 3.10.2 But backdating can lead to jail time

*Never backdate a contract for deceptive purposes*, e.g., to be able to report a sale in an already expired financial period — that practice has sent more than one corporate executive to prison for securities fraud, including at least one general counsel.

• The former CEO of software giant Computer Associates, Sanjay Kumar, served nearly ten years in prison for securities fraud through, among other things, backdating sales contracts (NY Times). Kumar was also fined $8 million and agreed to settle civil suits by surrendering nearly $800 million (NY Times).

Kumar wasn't the only executive at Computer Associates (now known as just CA) to get in trouble for backdating. All of the following went to prison or home confinement: – the CFO: seven months in prison, seven months home detention (NY Times); the general counsel: two years in prison, and also disbarred (court opinion); the senior vice president for business development: ten months of home confinement (NY Times); the head of worldwide sales: seven years in prison (WSJ).

All of this mess came about because the Computer Associates executives orchestrated a huge accounting fraud: On occasions when the company realized that its quarterly financial numbers were going to miss projections, it "held the books open" by backdating contracts signed a few days after the close of the quarter. This practice was apparently referred to internally as the "35-day month." According to CA, all the sales in question were legitimate and the cash had been collected (according to CA's press release).

The only issue was one of the *timing* of "revenue recognition," to use the accounting term: The company had recorded the sales on its books ("booked the

sale") a few days earlier than was proper under generally-accepted accounting principles, or "GAAP."

But that was enough to put the sales revenue into an earlier reporting period than it should have been — and that, in turn, was enough to send all those CA executives to prison. (CA press release).

• Likewise, the former CFO of Media Vision Technology was sentenced to three and a half years in federal prison because his company had inflated its reported revenues, in part by backdating sales contracts. Because of the inflated revenue reports, the company's stock price went up, at least until the truth came out, which eventually drove the company into bankruptcy.

Even if backdating a contract didn't land one in jail, it could can cause other problems. For example, a California court of appeals held that backdating automobile sales contracts violated the state's Automobile Sales Finance Act (although the state's supreme court later reversed).

> See Raceway Ford Cases, 2 Cal. 5th 161, 211 Cal. Rptr. 3d 244, 385 P.3d 397 (2016).

## 3.11 Signature *authority*

### 3.11.1 Do the (human) signers have signature authority?

Suppose that Alice signs a contract on behalf of ABC Corporation. The contract is with XYZ Inc. **Question:** Is it reasonable for XYZ to assume that Alice's signature makes the contract binding on ABC? The answer will depend on whether Alice had authority to do so — either actual authority or apparent authority.

### 3.11.2 Lack of signature authority can kill a contract

A party might not be able to enforce a contract if the person who signed on behalf of the other party did not have authority to do so. This happened, for example, in a federal-contracting case:

- An ammunition manufacturer signed several nondisclosure agreements (NDAs) with the U.S. Government and, under the NDAs, disclosed allegedly-trade-secret technology to the government.
- The manufacturer later sued the government for breaching the NDAs by disclosing and using the trade secrets without permission.
- Under the applicable regulations, the specific individuals who signed the NDAs on behalf of the government did not have authority to bind the government.

The court majority held that the government was not bound by some of the NDAs — and thus the government was not liable for its disclosure and use of the manufacturer's trade secrets.

> See Liberty Ammunition, Inc. v. United States, 835 F.3d 1388, 1401-02 (Fed. Cir. 2016). In dissent, Judge Newman argued that the senior Army officer who signed a particular NDA had at least apparent authority, and so (said the judge) the government should have been bound by the NDA. *See id*. at 1403-05; see also the discussion of apparent authority below.

Here's another example from the Illinois supreme court: A landlord sued its defaulting tenant, a union local. The landlord won a $2.3 million judgment against the union in the trial court, only to see the award thrown out in the state supreme court. Why? Because in signing the lease, the union official had not complied with the requirements of the state statute that authorized an unincorporated association to lease or purchase real estate in its own name.

> See 1550 MP Road LLC v. Teamsters Local No. 700, 2019 IL 123046, 131 N.E.3d 99.

### 3.11.3 An "officer" title won't necessarily indicate signature authority

The Restatement (Third) of Agency notes that just because a person holds the title of president or vice president of a company, that doesn't mean the person has authority to make commitments on behalf of the company.

> See Restatement (Third) of Agency § 3.03 cmt. e(4) (2006), *quoted in* Elaazami v. Lawler Foods, Ltd., No. 14-11-00120-CV, slip op. at n.6 (Tex. App—Houston [14th Dist.] Feb. 7, 2012) (reversing judgment notwithstanding verdict; company's vice president of operations had apparent authority to make oral promise of bonus payment to later-fired employee).

### 3.11.4 But *apparent* authority can save the day

An individual who has "apparent authority" can bind a party to a contract, *unless* a hypothetical reasonable person would have reason to suspect otherwise. This is true even if the party had had an *internal* signature policy prohibiting the individual from signing the type of contract in question. Something like happened, for example, in a Tenth Circuit case in which a company claimed that it was not bound by a contract signed by one of its executive vice president ("EVP").

> See Digital Ally, Inc., v. Z3 Tech., LLC, 754 F.3d 802, 812-14 (10th Cir. 2014); see generally https://en.wikipedia.org/wiki/Apparent_authority.

A Houston appeals court noted that:

> Texas law recognizes that a company's placement of an officer or employee in a certain position will provide the agent with *apparent* authority to bind the company in *usual*, customary, or ordinary contracts that a *reason-*

> *able* person would view as being *consistent* with an agent's scope of authority in that position.
>
> Elaazami v. Lawler Foods, Ltd., No. 14-11-00120-CV, slip op. at part III (Tex. App—Houston [14th Dist.] Feb. 7, 2012) (citing cases; emphasis added).

### 3.11.5 The gold standard: A board resolution — but not for everyday

The gold standard of corporate signature authority is probably a certificate, signed by the secretary of the corporation, that the corporation's board of directors has granted the signature authority.

You've probably seen paperwork that includes such a certificate if you've ever opened a corporate bank account. The resolution language — which is invariably drafted by the bank's lawyers— normally says something to the effect that the company is authorized to open a bank account with the bank in question and to sign the necessary paperwork, along with many other things the bank wants to have carved in stone.

> See this example of a corporate board resolution and officer certificate (contracts.OneCLE.com).

But a large- or publicly-traded company won't want to bother its board approval to get approval for for routine contracts or other everyday business.

### 3.11.6 Consider asking for a *personal* signer representation

Suppose that "Alice" is designated to sign a contract on behalf of a party, and that the contract includes a *personal* representation by Alice that she has authority to sign on behalf of that party, such as the following:

> Each individual who signs this Agreement on behalf of an organizational party represents that he or she has been duly authorized to do so.

But now suppose that Alice balks because she doesn't want to put herself on the hook in case she in fact doesn't have authority. That might be a sign that the other party should investigate whether Alice really does have authority to sign.

**Caution:** Even if a signer were to make a written representation that s/he had signature authority, that might not be enough — because legally the other side might be "on notice" that the signer does *not* have authority, as discussed in the following example.

### 3.11.7 Or, just take the risk?

The present author once represented a MathWhiz-like client that was negotiating an agreement with a Gigunda-like customer.

- Gigunda's attorney filled in a name and title for Gigunda's signer: It was a Gigunda individual contributor; let's call her "Sarah" (not her name).
- I raised the issue of apparent authority with the MathWhiz senior executive, who responded that he had been dealing exclusively with Sarah in negotiating the agreement, but that Sarah's boss (whom the MathWhiz executive knew well) had been copied on all of the emails going back and forth.
- The MathWhiz executive also said that MathWhiz had a longstanding good history with Gigunda.

After learning all of the above, my recommendation to MathWhiz was that we *not* try to change the signature block to reflect someone else's title — it might offend Sarah, and it would certainly delay getting to signature, with little or no *real* reduction in MathWhiz's business risk.

MathWhiz did as I recommended; the parties signed the contract and carried it out to everyone's satisfaction.

### 3.11.8 Special case: Legal limits on signature authority

By statute, a contract with an LLC or other organization might not be enforceable, even if signed by an "officer" or by a "manager." That could be the case if the articles of organization (which are usually publicly available) expressly *deprive* the signer of such authority.

This happened in a Utah case where:

- One manager of a two-manager LLC signed an agreement granting, to a tenant, a 99-year lease on a recreational-vehicle pad and lot.
- But there was a problem: The LLC's publicly filed articles of organization stated that neither of the two company's managers had authority to act on behalf of the LLC without the other manager's approval.

The court held that the tenant had been on notice of the one manager's lack of authority to grant the lease on just his own signature alone — and so the lease was invalid.

> See Zions Gate RV Resort, LLC v. Oliphant, 2014 UT App 98, 326 P.3d 118, 121 ¶ 8, 122-23. The court remanded the case for trial as to whether the LLC had later *ratified* the lease.

### 3.11.9 Consider including authority-*disclaimer* language

Some drafters might want to be explicit about who does *not* have signature authority, to help preclude a party from claiming to have relied on the apparent authority of other would-be signers.

This approach can sometimes be seen in sales-contract forms used by car dealer, which can say, typically in all-caps, something along the lines of, "NO PERSON HAS AUTHORITY TO MODIFY THESE WARRANTIES ON BEHALF OF THE DEALER EXCEPT A VICE PRESIDENT OR HIGHER."

## 3.12 Notary certificates *(skim)*

Contracts generally *aren't* notarized, but sometimes ancillary documents (e.g., deeds, assignments) might be.

This section discusses the certificate of *acknowledgement* by a notary public or other authorized official; that's a different type of certificate than a jurat, in which a notary or other official certifies that the signer of the document personally declared, under penalty of perjury, that the document's contents were true.

### 3.12.1 Litigation advantage: Self-authentication

A document such as a deed to real property might include, after the signature blocks, a space for a notary to sign a certificate that the signer:

1. appeared before the notary;
2. presented sufficient evidence to establish his or her identity (e.g., a driver's license, a passport, etc.); and
3. stated to the notary that he or she (the signer) signed the document.

Why do this? Because in many jurisdictions, the notary's signed certificate and official seal will serve as legally-acceptable evidence that the document isn't a forgery — that is, that the document is authentic. (This is sometimes referred to as making the document *self-authenticating* or *self-proving*.)

And indeed, the law likely *requires* a notary's certificate of acknowledgement if the document is to be recorded in the public records so as to put the public on notice of the document's contents. *Example:* Suppose that "Alice" is selling her house. To do so, she will ordinarily sign a deed and give the deed to "Bob," the buyer. Bob will normally want to take (or send) the deed to the appropriate government office to have the deed officially recorded; that way, under state law, third parties will be on notice that *Bob* now owns Alice's house.

But how can a later reader know for sure that the signature on the deed to Alice's house is in fact Alice's signature and not a forgery? The answer is that under the laws of most states, Alice's deed to Bob won't even be eligible for recording in the official records unless the deed includes an acknowledgement certificate, signed by a notary public or other authorized official, that Alice

complied with the three numbered requirements at the beginning of this section.

(And if Alice signed the deed in a special capacity, such as executor of her father's estate, then the notary's certificate will usually say that, too.)

Once Alice has done this, the notary will sign the certificate and imprint a seal on the deed. The notary might do this with a handheld "scruncher" that embosses the paper of the deed, or instead with an ink stamp; this will depends on the jurisdiction.

Typically, the notary is also required to make an entry in a journal to serve as a permanent record.

> *Pro tip:* It's useful to confirm that the notary in fact did this — a family friend of the present author once won a lawsuit by getting a notary to admit, on cross-examination, that she (the notary) had not made such an entry in the "well-bound book" that was then required by state law.

This acknowledgement procedure allows the civil servants who must record Alice's deed to look at the deed and have at least some confidence that the signature on it isn't a forgery.

Incidentally, state law usually determines just what wording must appear in an acknowledgement.

In some jurisdictions, Alice is not required to actually *sign* the deed in the presence of the notary; she need only acknowledge to the notary that yes, she signed the deed.

> See generally Kelle Clarke, Notary Essentials: The Difference Between Acknowledgments And Jurats (NationalNotary.org 2020).

### 3.12.2 Other officials might also be able to "notarize"

By statute, certain officials other than notaries public *(note the plural form)* are authorized to certify the authenticity of signatures in certain circumstances. For example, Texas law gives the power to certify signature acknowledgements to:

- district-court and county-court clerks; and
- in certain cases, to commissioned officers of the U.S. armed forces;

among others.

> See Tex. Civ. Prac. & Rem. Code § 121.001.

### 3.12.3 Notaries and conflicts of interest

A notary public generally can't sign a certificate if the notary has a conflict of interest, e.g., notarizing something for an immediate-familly member.

See generally, e.g., American Society of Notaries, Conflicts of Interest (2008).

But Texas law specifically allows a corporate employee (who is a notary public) to certify the acknowledgement of a signature on a document in which the corporation has an interest *unless* the employee is a shareholder who owns more than a specified percentage of the stock.

See Tex. Civ. Prac. & Rem. Code § 121.002.

### 3.12.4 A flawed notarization can cause problems

Parties will want to double-check that the notary "does the needful" (an archaic but useful expression) to comply with statutory requirements. In a New York case, a married couple's prenuptial agreement was voided *because the notary certificate for the husband's signature didn't recite that the notary had confirmed his identity*: It was undisputed that the couple's signatures were authentic, and there was no accusation of fraud or duress. Even so, said the state's highest court, the notarization requirement was important because it "necessarily imposes on the signer a measure of deliberation in the act of executing the document."

See Galetta v. Galetta, 21 N.Y.3d 186, 189-90, 191-92, 991 N.E.2d 684, 969 N.Y.S.2d 826 (2013) (affirming summary judgment that prenup was invalid).

### 3.12.5 *Lawyers* might not want to notarize client documents

In many states it's easy to become a notary public. Some lawyers themselves become notaries so that they can certify the authenticity of clients' signatures on wills, deeds, and the like.

But if a lawyer notarizes a document, then the lawyer might be called someday to testify in a court proceeding about a signed document. For example, the lawyer-notary might have to explain how he or she confirmed the signer's identity if that information isn't stated in the lawyer's notary records. That in turn might disqualify the lawyer from being able to represent the client whose signature was certified.

See, e.g., Tex. Civ. Prac. & Rem. Code § 121.001; Tex. Discipl. R. Prof. Conduct 3.08 ("Lawyer as Witness").

(As a practical matter, though, that might not be too much of an issue, because the lawyer might already have to testify by virtue of having participated in the events leading up to the signing of the document.)

### 3.12.6 Notarization by videoconference?

Drafters needing a notary certificate should check whether applicable law *requires* a personal appearance before a notary (or other official).

> See generally National Notary Association, Remote Notarization: What You Need to Know (nationalnotary.org Jun. 23, 2020) (showing states with remote-notary laws).

Remote notarization was an issue during the 2019-20 COVID-19 pandemic, during which the Texas governor announced an emergency suspension of some laws and authorized notarization of certain wills and real-estate documents.

> See Texas Secretary of State, Notice of Suspension of Statutes (undated; refers to a governor's order of Apr. 8, 2020 concerning wills, etc.) (sos.state.tx.us); also this order (notarization of real-estate instruments).

## 3.13 Exercises and discussion questions

### 3.13.1 Discussion questions: Title, preamble, background

1. FACTS: MathWhiz's CEO asks you to draft a confidentiality agreement ("NDA") between MathWhiz and a company she knows only as "Gigunda Energy," a multibillion dollar multinational corporation based in California. TRUE OR FALSE: In the NDA's preamble, it's OK to list Gigunda as simply "Gigunda Energy," without more. EXPLAIN.

2. For the NDA in #1, draft a title — consider the various title styles in § 3.4.

3. For the NDA in #1, what information would you want to find out about Gigunda to include in the preamble — and how might you go about acquiring that information?

4. For the NDA in #1, describe *two* ways you could avoid having to repeat the parties' full legal names throughout the contract. What are some pros and cons of each way?

5. How would you write the *very first* sentence of the NDA's preamble?

6. In the NDA's preamble, how important is it to include the parties' full legal names, and why? What about their state(s) of incorporation or other organization?

7. In the NDA's preamble, would you say that the confidentiality is (i) "between," or (ii) "by and between," or (iii) "among," Gigunda and MathWhiz?

8. Why might you want to include the city and state of Gigunda's *principal place of business* in the NDA's preamble?

9. Why might you want to include Gigunda's *initial address for notice* in the NDA's preamble?

10. MORE FACTS: MathWhiz's CEO tells you that she and her contact at Gigunda have already discussed, on a Zoom call, a limited amount of each par-

ty's confidential information but they agreed orally to keep the information confidential. QUESTION: Is that oral agreement enforceable?

11. Same facts as #10: How could you set up the *written* NDA to cover the previous Zoom call?

12. MORE FACTS: MathWhiz's CEO tells you that Gigunda wants the NDA to cover not just Gigunda's confidential information, but also some confidential information of Gigunda's wholly-owned Mongolian subsidiary. QUESTION: How could you do that?

13. Exercise: Using what you know from the above, draft a very simple "Background" section for the NDA.

14. To what extent would you want to put specific details of the NDA — for example, how long the confidentiality obligations of the NDA will last — into its *Background* section?

15. FACTS: Gigunda's lawyer has prepared a draft of the NDA, which says at the beginning: "This Agreement is made effective January 31, 20xx." MathWhiz's lawyer has asked you to review the draft and make any necessary revisions. QUESTION: Would you change the just-quoted sentence to state that the Agreement is effective the last date signed? Why or why not?

16. In the signatures-up-front example in § 3.7.8, what item of information is missing that could prove useful someday in the future? Why might that information be useful? How serious a flaw is it that this information is missing?

17. Draft a preamble and background section for the Gigunda-MathWhiz agreement.

18. True or false: In an agreement title that contains party names, the full legal names of the parties must be spelled out in full.

### 3.13.2 Discussion questions: Signatures

1. Explain if false: In the U.S., before parties can use electronic signatures, they must first sign a hard-copy preliminary agreement that they can use electronic signatures for subsequent agreements.

2. Explain if false: Nowadays, most contracts get printed out in two copies, and each copy is signed by both parties, so that each party will have one, fully-signed original to keep.

3. Explain if false: It's not a great idea to put signature blocks at the front of a contract. EXPLAIN.

4. Explain if false: It's a good idea to include language such as the following just before the signature blocks: "To evidence the parties' agreement to this Agreement, each party has executed and delivered it on the date indicated under that party's signature."

5. Explain if false: Signature blocks should have the "date signed" spaces pre-filled in so that the signers won't have to remember to write in the dates.

6. Explain if false: Each individual signer's signature block should have a blank space for the signer to handwrite in the date signed.

7. Explain if false: It's OK to let a signature block get split between two different hard-copy pages (that is, the first part of the signature block is at the bottom of one page and the remainder is at the top of the next page).

8. What feature of Microsoft Word can you use to get two signature blocks side-by-side on the page? *(Hint: It starts with "T.")*

9. *(From Contracts 101 for 1Ls:)* By law, what's the significance of the last date signed?

10. Explain if false: The signature block for a corporation or LLC can just state the individual signer's name, e.g., "Jane Doe," without any other information.

11. FACTS: ABC Corporation's marketing department is negotiating a contract with social-media giant Foogle for a $10 million online advertising campaign to promote ABC's products. At the request of ABC's director of marketing, ABC's vice president for human resources Allen Baker Cole signs the contract. BUT: ABC's CEO learns about the contract and immediately demands that it be set aside, because the CEO had planned to use that money for other things. ABC's internal policy manual states that all advertising contracts must be signed by the executive vice president for sale. QUESTION: Can ABC use Allen's lack of authority as a reason to cancel the advertising contract?

12. DIFFERENT FACTS: Before the advertising contract was signed, ABC's vice president of marketing sent an email to his contact at Foogle, stating that only he (the VP of marketing) had authority to sign the advertising contract; the Foogle contact emailed back, saying "fine, that works for us." QUESTION: Does that change your answer in #11 above? If so, how?

13. Explain if false: It's generally OK for an attorney to sign on behalf of a client as long as the signature (or signature block) indicates that the attorney is signing in that capacity and not as an officer of the client or as an individual party.

14. Explain if false: It's generally OK for a company's vice president and general counsel to sign a contract with Thomson West for the legal department's Westlaw subscription.

15. If exchanging signed signature pages only, how can you make sure each party's signed signature page is from the same version of the contract? *(In one case, discussed in the reading, this was a problem — what happened there?)*

16. When (if ever) might it be appropriate to do the following:

- Appropriate to backdate the effective date of a contract
- INappropriate to backdate the effective date of a contract
- Appropriate to backdate the signers' signatures
- INappropriate to backdate the signers' signatures

### 3.13.3 Discussion questions: Notary certificates

1. FACTS: Your client, Landlord, has negotiated a five-year commercial lease for one of its office buildings. The tenant's lawyer wants the signers to have their signatures notarized. Landlord agrees to have the signatures notarized. ASSUME: All events take place in Texas and are subject to Texas law. QUESTION: *Why* might the tenant's lawyer want the lease to be notarized? Would that be in your client Landlord's best interest? EXPLAIN.

> See generally J. Allen Smith & Michael R. Steinmark, Tenants' Rights Under Unrecorded Leases, at http://goo.gl/S2prC (2010); Tex. Prop. Code §§ 12.001, 13.001, 13.002.

2. If the notary public can't find her notary seal, may she sign the notary certificate and skip applying the seal? EXPLAIN.

> See Tex. Gov. Code § 406.013; Tex. Civ. Prac. & Rem. Code § 121.004.

3. What must the notary public do *before* signing the notary certificate to confirm that the signers are who they claim to be?

> See Tex. Civ. Prac. & Rem. Code § 121.005(a).

4. Must the notary's certificate say anything in particular about the identity of the signer? EXPLAIN.

> See Tex. Civ. Prac. & Rem. Code § 121.005(b).

5. What must the notary do *after* notarizing the signature(s)? EXPLAIN.

> See Tex. Civ. Prac. & Rem. Code § 121.012; Tex. Gov. Code § 406.014.

6. If no notary is around, can *you* notarize the signatures as an attorney? *Should* you? EXPLAIN.

> See Tex. Civ. Prac. & Rem. Code § 121.001; Tex. Discipl. R. Prof. Conduct 3.08 ("Lawyer as Witness").

7. Surprise! The person who will sign the lease for the tenant has gone on a business trip to Kuwait and will FAX her signed signature page to you. Can your secretary, who is here in Houston and is a notary public, notarize that signature page? EXPLAIN.

> See Tex. Civ. Prac. & Rem. Code § 121.004(a).

8. Who *in Kuwait* could "notarize" the tenant signer's signature? EXPLAIN.

See Tex. Civ. Prac. & Rem. Code § 121.001.

9. *Why* "notarize" a document signature with an *acknowledgement*, as opposed to a jurat? EXPLAIN.

# Chapter 4 Defined terms

Defined terms can be quite useful — not least because they allow drafters to change the definition for, say, "Purchase Price" to reflect a new dollar figure, without having to revise the dollar figure multiple times throughout the contract.

See also the "D.R.Y. — Don't Repeat Yourself" rule discussed at Section 8.8: .

## 4.1 The benefits of "in-line" definitions

It's often convenient to include definitions "in-line" with the substantive provisions in which they are used; see, for example, the way that "Buyer" and "Seller" are defined in Section 3.5: .

When you keep definitions together with their substantive provisions in this way, it makes it easier for future drafters to copy and paste an entire contract article or section into a new contract.

## 4.2 Have a separate section for general definitions?

It's also common to use a separate “general definitions” section and to place it in one of three spots in the contract:

1. right after the Background section — this is perhaps the most-common practice;

2. at the back of the contract, just before the signature blocks or as an appendix after the signature blocks (with results that might be surprising, as discussed in the note just below);

> On his blog, IACCM founder and president Tim Cummins told of an IACCM member whose company saved hours of negotiating time — up to a day and a half per contract — by moving the “definitions” section from the front of its contract form to an appendix at the back of the document. Cummins recount-

> ed that "by the time the parties reached 'Definitions', they were already comfortable with the substance of the agreement and had a shared context for the definitions. So effort was saved and substantive issues were resolved." Tim Cummins, Change does not have to be complicated (July 21, 2014).

3. in a separate exhibit or schedule (which can be handy if using the same definitions for multiple documents in a deal).

## 4.3 Pro tip: Include cross-references

In some contracts you might have both "in-line" definitions *and* a separate general-definitions section. In that situation, you should seriously consider serving future readers by including, in the separate general-definitions section, appropriate cross-references (in their proper alphabetical spots) to the in-line definitions.

That way, the general-definitions section does additional duty as a **master index** of defined terms.

## 4.4 Some defined-terms style preferences

The following are some personal style preferences that enhance readability (in the author's view):

– Put the defined term in "*quotes and italic type*" to make it stand out on the screen or page and thus make the term easier to spot while scanning through the document.

– Use the phrase *refers to* instead of *means*, because the former often just sounds better in different variations; see the following example (where bold-faced type is used to highlight differences and not to set off defined terms):

*Before:*

> Confidential Information **means** information where all of the following are true ….

*After:*

> "*Confidential Information*" **refers to** information where all of the following are true ….

## 4.5 Don't bother numbering alphabetized definitions

If you alphabetize your defined-terms section (as you should), there's no need to number the paragraphs. The purpose of numbering contract paragraphs is easy referencing, both internally and in later documents. That purpose is sufficiently served just by having the definitions in alphabetical order.

> Ken Adams gives an example of a real-world contract that contained so many defined terms, in alphabetically-lettered paragraphs, that the paragraphs went from (a), (b), (c), etc., all the way to (ccccccccc), that is, with ten "c" letters. Just imagine trying to cite *that* in a cross-reference or a legal brief. See Ken Adams, Deranged Definition-Section Enumeration (AdamsDrafting.com 2020).

## 4.6 Caution: Consistency in capitalization can be crucial

It's a really good idea to be consistent about capitalization when drafting a contract. If you define a capitalized term but then use a similar term without capitalization, that might give rise to an ambiguity in the language — which in turn might preclude a quick, inexpensive resolution of a lawsuit.

That kind of bad news happened in a New York case:

- The defendant asserted that the plaintiff's claim was barred by the statute of limitations and therefore should be immediately dismissed.
- The plaintiff, however, countered that the limitation period began to run much later than the defendant had said.
- The court held that inconsistency of capitalization of the term "substantial completion" precluded an immediate dismissal of the plaintiff's claim.

> See Clinton Ass'n for a Renewed Environment, Inc., v. Monadnock Construction, Inc., 2013 NY Slip Op 30224(U) (denying defendant's motion to dismiss on the pleadings).

In a similar vein, a UK lawsuit over flooding of a construction project turned on whether the term "practical completion" — uncapitalized — had the same meaning as the same term capitalized. The court answered that the terms did not have the same meaning; as result, a sprinkler-system subcontractor was potentially liable for the flooding.

> See GB Building Solutions Ltd. v. SFS Fire Services Ltd., (2017) EWHC 1289, discussed in Clark Sargent, Antonia Underhill and Daniel Wood, Ensure That Defined Terms Are Used Consistently; Ambiguity Can Be Costly (Mondaq.com 2017).

# Chapter 5 Exhibits, schedules, etc.

This section describes typical practice in U.S. contract drafting; the terminology might be different in other jurisdictions.

## 5.1 Exhibits: Standalone documents (generally)

A contract exhibit is generally a standalone document attached to (or referenced in) a contract. Exhibits are often used as prenegotiated forms of follow-on documents such as forms of real-estate deed.

*Example:* Imagine that ABC Corporation and XYZ Inc. sign a contract under which XYZ will buy an apartment complex from ABC. Such contracts usually provide:

- for the buyer to have a period in which to have the house inspected and, if necessary, to obtain financing; and
- after that, for a "closing" in which:
    - the buyer is to pay the purchase price; and
    - (relevantly here:) the seller is to deliver a deed that conveys title to the buyer.

In a commercial real-estate contract such as the one between ABC and XYZ, the contract might well include, *as an exhibit*, an agreed form of warranty deed; the contract might say the following, for example:

> … At the Closing (subject to Buyer's fulfillment of Buyer's obligations under this Agreement), Seller will deliver to Buyer a general warranty *in substantially the form attached to this Agreement as Exhibit A*.

(Emphasis added.)

*Example:* A master services agreement might include, as an exhibit, a starter template for statements of work to be undertaken under the agreement.

*Exhibit numbering:* Contract exhibits are commonly "numbered" as Exhibit A, B, etc., but that's just a convention; exhibits could alternatively be numbered with numerals, such as Exhibit 1, 2, etc., or even by reference to section numbers in the body of the contract (see the discussion of schedules below). The important thing is to make it easy for future readers to locate specific exhibits.

## 5.2 Schedules: For disclosures of exceptions from a benchmark

Schedules are commonly used in contracts for disclosures of exceptions to representations and warranties in the body of the contract. *Example:* In the merger agreement between software giant Symantec Corporation and BindView Corporation (of which the author was vice president and general counsel), BindView warranted, among other things, that:

> Article 3
> Representations and Warranties of the Company * * *
>
> 3.2 Company Subsidiaries. *Schedule 3.2 of the Company Disclosure Letter sets forth* a true, correct *[sic]* and complete list of each Subsidiary of the Company (each a "Company Subsidiary"). …
>
> Other than the Company Subsidiaries *or as otherwise set forth in Schedule 3.2*, the Company does not have any Company Subsidiary or any equity or ownership interest (or any interest convertible or exchangeable or exercisable for, any equity or ownership interest), whether direct or indirect, in any Person.

(Italics and extra paragraphing added.)

In other words: The reps and warranties in the contract set forth **a baseline** reference point — a benchmark, **a Platonic ideal** — while the schedule(s) specify how the Company (in this case, BindView) did not conform to that benchmark status.

*Schedule numbering:* It's conventional to number each schedule according to the section in the body of the agreement in which the schedule is primarily referenced; in the example above, Schedule 3.2 has the same number as section 3.2 of the merger agreement in which that schedule is referenced.

## 5.3 Appendixes, addenda, annexes

Other materials can be attached to a contract as appendixes, annexes, and addenda; there's no single standard or convention for doing so.

# Chapter 6 Street smarts: Your career

One of the aims of this book is to help young lawyers and other contract professionals to quickly achieve "seasoned pro" status; this chapter suggests a few things that can help in that effort.

Contents:



## 6.1 In style disputes, your supervisor wins*

* *Subject to ethical boundaries and potential criminal liability, of course*.

A new lawyer or other contract professional might find that her partner or other supervisor prefers to write out, for example, *one million seven hundred thousand dollars ($1,700,000.00)*, instead of the simpler $1.7 million, even though this book strongly recommends against doing so.

> This approach of spelling out numbers, and then repeating with numerals, once cost a Dallas-area lender $693,000, as explained in Section 8.8: , "D.R.Y. — Don't Repeat Yourself."

*But don't fight your supervisor over things like this*; in purely-stylistic matters, *just do it the way that the supervisor prefers*. There'll be plenty of time to develop and use your own preferred style as you get more experienced and more trusted to handle things on your own — and especially if you start to bring in your own clients.

(In the meantime, of course, you'll have to be extra-careful not to make the kind of mistakes that can result from some of these suboptimal style practices.)

## 6.2 Dealing with "the other side's" draft

Many contract drafters spend *at least* as much time reviewing others' draft contracts as they do in drafting their own. Here are a few pointers.

1. **Do ask the other side for an editable Microsoft Word document**. And if you send *the other side* a draft or a redline, don't send a PDF or a locked Word- or PDF document — doing so implicitly signals a lack of trust; between lawyers especially, it's more than a little lacking in professional courtesy.

2. **Do save your own new draft immediately:** Open the other party's draft in Microsoft Word *and immediately save it as a new document* whose file name reflects your revision. *Example of file name:* "Gigunda-MathWhiz-Services-Agreement-rev-2020-08-24.docx"

3. **Do add a running header to show the revision date:** Add a running header to the top right of every page of your revision to show the version date and time (typed in, **not** an updatable field) (and matching the date in the file name). *Example of running header:* "REV. 2020-08-24 18:00 CDT" (note the use of military time for clarity).

4. **Don't revise the other side's language just for style:** It's not worth spending scarce negotiation time — and it won't go over well with either the other side *or the client* — to ask the other side to change things that don't have a substantive effect.

*Example:* Suppose that the other side's draft contract leads off with "WITNES-SETH" and a bunch of "WHEREAS:" clauses. As a well-trained drafter, you'd prefer to have a simple background section without all the legalese (see § 3.6 for more details). **Let it be:** If the other side's "WHEREAS:" clauses are *sub-stantively* OK, don't revise those clauses just because *you* (properly) prefer to use a plain-language style.

5. **But do break up "wall of words" provisions** in another party's draft to make the provisions easier for your client to review — and to help *you* to do a thorough review with lower risk of the MEGO factor ("Mine Eyes Glaze Over"). After you save a new Word document (see #2 above), do the following:

- Double-space the entire text (except signature blocks and other things that should be left in single-space) if not that way already.
- Break up long sentences, as explained in more detail at § 7.5.

6. **And do add an explanation for the added white space:** In the agree-ment title at the top of the draft, add a Word comment bubble along the lines of the following:

> To make it easier for my client to review this draft, I'm taking the liberty of double-spacing it and breaking up some of the longer paragraphs.

(It's hard for another lawyer to object to your doing something to make things easier for your client, right?)

The author has been doing this for years and has only once gotten pushback on that point from the original drafter — in fact, the parties pretty much always end up eventually signing a double-spaced version with broken-up paragraphs, as opposed to the original wall-of-words format.

7. **Never gratuitously revise another party's draft to favor the *other* party** — even if your revision seems to make *business* sense — *and certainly not* if the revision might someday put your client at a disadvantage or give up an advantage.

*Example:* Suppose that this time your client MathWhiz is *a customer*, not a vendor. A vendor that wants to do business with MathWhiz has sent MathWhiz a draft contract. The draft calls for MathWhiz to pay the vendor's invoices "net 90 days" — that is, the vendor expects MathWhiz to pay in full in 90 days.

- You know that vendors like to be paid as soon as they can, so you suspect that the vendor's *90-day* terms are a mistake, perhaps left over from a previous contract; i.e., the vendor's contract drafter might have taken a previous contract and changed the names, but without changing the 90-day terms to, say, 45-day terms.
- You know that MathWhiz, like all customers, pretty-much always prefer to hold onto its cash for as long as they can — not least because delaying payment can give a customer a bit of extra leverage over its suppliers.
- You also know that MathWhiz usually pays net-45 and is even willing to pay net-30 if the other terms are acceptable.

*Let it be — don't take it on yourself* to unilaterally change the vendor's net-90 terms to net-45, because that would require MathWhiz to pay the vendor's invoices *earlier* than the vendor asked in its draft contract.

The vendor's drafter might later embarrasedly confess to having overlooked the net-90 terms and *ask* to change it to net-30. That gives MathWhiz an opportunity to be gracious, which will usefully signal to the vendor that MathWhiz might well be a Good Business Partner (which most companies like to see).

This is also a lesson about the possible danger of reusing an existing contract without carefully reviewing it to identify — and *possibly* strip out — any concessions that were made in the course of previous negotiations.

## 6.3 The Check-In Rule

As a junior lawyer, there will be times when you will — and should — be uncertain about what to do in a contract draft. For example:

• When *drafting* a contract for a client, you might wonder whether to include a forum-selection provision, because doing so can lead to problems in negotiation (the other side might insist that their home city be the exclusive forum).

• In *reviewing* another party's draft contract, you might see that the draft includes a forum-selection provision that requires all litigation to take place ex-

clusively in the other side's home jurisdiction; you wonder whether the client will be OK with that.

To keep your client and your supervising partner happy (not to mention your malpractice carrier) here's what you do:

1. **Check in with your supervising partner** — or, if you're the person who deals with the client, *check in with the client* — about the issue that concerns you, which here is the forum-selection provision.

*Important:* Have a well-thought-out recommendation for *what to do* about the issue of concern, *with reasons* for your recommendation. This is true even if the recommendation is limited to advising the client to consider Factors X, Y, or Z in making a decision. That will give the partner or client a concrete proposal to consider, instead of just wondering about the issue in the abstract. (Also, superiors and clients tend to think, not unreasonably: *Bring me [proposed] solutions, not just problems*.)

*Note:* Don't pick up the phone and call the partner or client every time an issue pops into your head — no one likes to be repeatedly interrupted with questions. Instead:

- make a list of things to discuss with the partner or client; and
- schedule a meeting or phone call (or Zoom call) to discuss the list.

*Pro tip:* In Microsoft Word, you can add comment bubbles in the margin of a draft contract. Those comment bubbles can then be used as the discussion agenda during what's known as a "page turn" conference call, where the participants go page by page through a draft contract or other document. (Ditto for discussing comments with the other side during a negotiation call.)

2. **Document that you advised the client or partner** — in matter-of-fact, non-defensive language — either:

- in an email to the partner or client, and/or
- in Word comment bubbles in a draft that you sent to the partner or client, as discussed in the pro tip above.

**Here's a real-life example:** A client's CEO once asked me to review a draft confidentiality agreement ("NDA") sent to him by a giant company.

> At the time, I'd been working with the CEO for many years, helping him do his job at several different companies where he'd been a senior executive (two of which companies he founded). This illustrates an important career-development lesson for new lawyers: The people you deal with at your clients will sometimes change jobs or start their own companies. In their new positions, these folks might well have occasion to hire outside counsel, and they'll *prefer* to use lawyers whom they already know

> and with whom they're comfortable working. Over time, this can be an important source of business for lawyers.

Here's the email I sent the CEO about the giant company's NDA form, only lightly edited:

> 1. They *[the giant company]* have their infamous "residuals clause" in this NDA, which is basically a blank check for them to use whatever you tell them — in *[section reference]* it says:
>
> "Neither of us can control … what our representatives will remember, even without notes or other aids. We agree that use of information in representatives' *unaided memories* in the development or deployment of our respective products or services *does not create liability* under this agreement or trade secret law, and we agree to *limit what we disclose* to the other accordingly." (Emphasis added.)
>
> BUSINESS QUESTION: **Are you OK** with giving *[the giant company]* that kind of a blank check for what you'll be disclosing to them?
>
> 2. **Any litigation would have to be in *[city]*. Meh.** *[DCT comment: I certainly wouldn't have been this informal with someone with whom I didn't have such a longstanding relationship.]*
>
> 3. There's no requirement that a recipient must return or destroy confidential information. **I'm fine with that**; I've come to think that omitting such a requirement is the most-sensible approach.
>
> Otherwise it *[the giant company's draft NDA]* looks OK.

Notice what I did here: I pointed out three issues — in numbered paragraphs — for which I wanted the CEO's input, *and* **I made recommendations** as to the second two; the CEO would ultimately make the decisions *what business risks to accept*.

*Epilogue:* The CEO emailed me back and asked for a phone conference with him and another executive. That time, I *didn't* follow up with an email to confirm the plan of action we'd agreed on, but if I had done so, the confirming email might have been along the following lines:

> **Confirming part of our phone conversation today**: The [giant company] NDA has an exclusive forum-selection provision that requires all litigation to be in [city]; under the circumstances I think that's probably **an acceptable business risk**.
>
> **Please let me know if you'd like to discuss this any further**.

(Emphasis added.) Note how, in the first sentence, I left a paper trail for future litigation counsel, documenting the facts: (i) that we had a phone conversation, and (ii) when that conversation occurred.

Note also my use of the term "acceptable business risk," signaling that this was a judgment for the client to make.

IMPORTANT: Be careful about how you phrase your emails and other comments to the client or partner: *Assume* that *anything* you put in writing *might* someday be read by an adversary and possibly used against your client — or against you — in litigation.

Sure, in some circumstances the attorney-client privilege *should* protect at least some of your written comments from discovery. But the privilege has its limits; moreover, the privilege can be waived (by the client only), or it might even be pierced (if the crime-or-fraud exception applies).

## 6.4 Note-taking during negotiations

Chances are that at some point in your career, a lawyer — yours, or someone else's — will want to review notes you took at a meeting or during a phone conversation. With that possibility in mind, whenever you take notes, you should routinely do as many of the following things as you can remember, **especially the first three things**. This will increase the chances that a later reviewer will get an accurate picture of the event, which in turn can help you stay out of undeserved trouble and save money on legal fees

1. **Indicate *who said what* you're writing down**. Unless you want to risk having someone else's statements mistakenly attributed to you, indicate in your notes just who has said what.

*Example:* Suppose that John Doe says in a meeting that your company's offshore oil-well drilling project can skip certain safety checks.

- Remembering the BP drilling disaster in the Gulf of Mexico, you don't want anyone to think you were the guy who suggested this.
- So your notes might say, for example, "*JD: Let's skip safety checks*."
- If you omitted John Doe's initials, it wouldn't be clear that you *weren't* the one who made his suggestion.

2. **On every page, write the meeting date and time, the subject, and the page number.** The reason: Your trial counsel will probably want to build a chronology of events; you can help her put the meeting into the proper context by "time-stamping" your notes. This will also reduce the risk that an unfriendly party might try to quote your notes out of context.

3. **If a lawyer is participating, indicate this.** That will help your lawyer separate out documents that might be protected by the attorney-client privi-

lege. EXAMPLE: *"Participants: John Doe (CEO); Ron Roe (ABC Consulting, Inc.); Jane Joe (general counsel)*."

4. **Start with a clean sheet of paper.** When copies of documents are provided to opposing counsel, in a lawsuit or other investigation, it's better if a given page of notes doesn't have unrelated information on it. This goes for people who take notes in bound paper notebooks too: It's best to start notes for each meeting or phone call on a new page, even though this means you'll use up your notebooks more quickly.

5. **Write in pen** for easier photocopying and/or scanning, and also because pencil notes might make a reviewer (for example, as an opposing counsel) wonder whether you might have erased anything, and perhaps falsely accuse you of having done so.

6. **Write "CONFIDENTIAL"** at the top of each page of confidential notes. That will help preserve any applicable trade-secret rights; it will also help your lawyer segregate such notes for possible special handling in the lawsuit or other investigation.

7. **List the participants.** Listing the participants serves as a key to the initials you'll be using, as discussed in item 1 above. It can also refresh your recollection if you ever have to testify about the meeting. If some people are participating by phone, indicate that.

8. **And indicate each participant's role** if isn't obvious or well-known – remember, you might know who someone is, but a later reader likely won't know. EXAMPLE: *"Participants: John Doe (CEO); Ron Roe (ABC Consulting, Inc.); Chris Coe (marketing)."*

9. **Indicate the time someone joins or leaves the meeting**, especially if it's you (so that you're not later accused of having still been there if something bad happened after you left).

10. **Write down the stop time of the meeting.** This usually isn't a big deal, but it's nice to have for completeness.

# Chapter 7 Street smarts: Client happiness

## 7.1 Perfect is the enemy of good enough - but …

When it comes to contracts, clients are firm believers that "perfect" is the enemy of "good enough." Clients generally would *far* prefer to get an "OK" contract that covers the reasonably-likely contingencies, *and get it signed quickly*; they don't want to waste calendar time, nor to pay for lawyers, to get a gold-plated contract that covers unlikely and/or low-risk possibilities.

Of course, part of the problem is that hindsight is 20-20: If an "unlikely" possibility in fact comes to pass and causes problems for the client, guess where fingers might well be pointed for not having covered that possibility in the contract? Hey, no one ever said life was fair.

## 7.2 The mission: Educating - and persuading? - readers

The author of a popular contract style manual once opined — wrongly — that, apart from the opening recitals, "in a contract you don't reason or explain. You just state rules." That view would be fine if it weren't for some inconvenient facts.

> Ken Adams, More Words Not to Include in a Contract— "Therefore" and Its Relatives, at http://www.adamsdrafting.com/therefore/ (2008).

1. Even in a business-to-business contract, it's *people*, not computers, who carry out obligations and exercise rights. (So-called digital "smart contracts" are a very-different thing.) Computers do *exactly* as they're told, but people? Not so much — at least not always reliably.

2. People sometimes forget — perhaps conveniently — what the parties discussed and agreed to, and who sometimes change their minds about what they regard important. That can be especially true, and memories can sometimes be "creative," when individuals' *personal* interests (often hidden) are involved; this means that people sometimes need to be reminded of what they agreed to.

3. A contracting party's circumstances can change after the contract is signed. For example:

   - By the time a dispute arises, key employees and executives of a party could have different views of what's important.
   - Or, those people might have "forgotten" what mattered during the contract negotiations.
   - The people who originally negotiated the business terms might not be in the same jobs; their successors might not know why the parties agreed to the terms that they did.

4. And let's not forget another important group of people: Judges, jurors, and arbitrators who are asked to enforce a contract can be influenced by what they think is "fair"; sometimes, the wording of the contract's terms can make a difference in how those future readers might perceive the parties' positions.

**The upshot:** People sometimes need to be educated — and even persuaded — to do the things called for by a contract. Explanations can serve as useful reminders on that score.

To be sure, the famous Strunck & White drafting guide counsels writers to "omit needless words." But the operative word there is *needless*. Sometimes, a few extra words of explanation in a contract can help nudge readers in the "right" direction.

*That's the contract drafter's mission:* To (re)educate the parties — and sometimes judges and jurors — and, if necessary, to persuade them, to do what your client now wants them to do.

## 7.3 Serve the reader!

When a client asks for a contract to be drafted, the client probably imagines (often correctly) that the *business* terms are pretty much agreed and that the only thing standing in the way of a done deal is "legal" — both the client's lawyer and the other side's lawyer.

But it's usually more-complicated than that: A contract will almost never get signed before it has been extensively reviewed, on both sides of the deal, by (often multiple) lawyers and business people, and sometimes by accountants, insurance professionals, and others.

A commenter on Twitter once remarked: "No one is reading your [contract] because they want to, but because they have to. So make it easy, not difficult, to read."

From https://twitter.com/virshup/status/1343272719916224513

Toward that end: To speed up the process — and keep the client happy on that score — make your contracts as easy to read and review as possible, given the time- and budget constraints under which you're working.

## 7.4 Plain language is "a thing"

It's hard to educate or persuade a reader when you write dense legalese; a judge in New York City opines: "The hallmark of good legal writing is that an intelligent layperson will understand it *on the first read*."

> Gerald Lebovits, Free at Last from Obscurity: Achieving Clarity, 96 Mich. B.J. 38 (May 2017), SSRN: https://ssrn.com/abstract=2970873 (emphasis added, footnote omitted).

The modern trend is decidedly to use plain language in contracts, and also in just about any other kind of document you can imagine.

> See the references cited by an informal consortium of U.S. Government civil servants in Plain Language in the Legal Profession (PlainLanguage.gov, undated).

This trend is by no means limited to *legal* documents; contract drafters can take a leaf from Warren Buffett:

> When writing Berkshire Hathaway's annual report, *I pretend that I'm talking to my sisters*. I have no trouble picturing them: Though highly intelligent, they are not experts in accounting or finance. They will understand plain English, but jargon may puzzle them
>
> *My goal is simply to give them the information I would wish them to supply me if our positions were reversed*.
>
> To succeed, I don't need to be Shakespeare; I must, though, have a sincere desire to inform.
>
> No siblings to write to? Borrow mine: Just begin with "Dear Doris and Bertie."

> U.S. Securities and Exchange Commission, Plain English Handbook at 2 (Aug. 1998) available at https://goo.gl/DZaFyT (sec.gov) (emphasis and extra paragraphing added).

### 7.4.1 Business people prefer plain language

Business people love plain language in contracts because:

- Plain language speeds up legal review, which is generally one of the biggest bottlenecks in getting a deal to signature.
- Plain language makes it more likely that potential problems will be spotted and fixed *before* signature — which reduces the opportunities for future disputes that could waste the parties' time, opportunities, and money.

In a 2018 article, the general counsel of a GE business unit reported that, when his group switched to plain-language contracts, the new contract forms "took a whopping 60% less time to negotiate than their previous legalese-laden versions did. … Customer feedback has been universally positive, and there hasn't been a single customer dispute over the wording of a plain-language contract."

Shawn Burton, *The Case for Plain-Language Contracts*, Harv. Bus. Rev. Jan.-Feb. 2018 at 134, archived at https://perma.cc/HW85-FGSA. When that article was published, Mr. Burton was the general counsel of GE Aviation's Business & General Aviation and Integrated Systems businesses.

### 7.4.2 Plain language helps trial counsel

Trial counsel also prefer plain language in a contract, because:

- Plain language offers better "sound bites" for trial exhibits and witness cross-examination; and
- During jury deliberations, plain language can help refresh jurors' recollections as part of the "real" evidence in the record, not merely as trial counsel's demonstrative exhibits (summaries, PowerPoint slides, etc.) that the judge might *or might not* allow to be taken back into the jury room.

See also the discussion of demonstrative exhibits at Section 12.5: .

## 7.5 Draft short, *single-topic* paragraphs - don't be a L.O.A.D.!

Don't be a L.O.A.D. (a Lazy Or Arrogant Drafter): Avoid dense, "wall of words" legalese, because in all likelihood, *a series* of short, plain statements of the parties' intent will do nicely.

Each paragraph in a contract draft (i) should be a few lines at most, and (ii) should address *a single topic*. That's because, other things being equal:

1. Short, single-topic paragraphs are less likely to be summarily rejected by a busy reviewer because she doesn't want to spend the time to decipher long complex sentences — when a contract *reviewer* represents a party that has some bargaining power (such as a gigantic retailer), it's not uncommon for the reviewer to simply delete a wall-of-words paragraph because she doesn't want to bother trying to puzzle through it.

2. Such paragraphs can be saved more easily for re-use, and later snapped in and out of a new contract draft like Lego blocks, without inadvertently messing up some other contract section.

3. Short, single-topic paragraphs are easier to revise if necessary during negotiation.

4. Such paragraphs reduce the temptation for the other side's reviewer to tweak more language than necessary — and that's a good thing, because even minor language tweaks take time for the other side to review and nego-

tiate; that in turn causes business people to get impatient and to blame "Legal" for delaying yet another supposedly-done deal.

**So:** If a sentence or paragraph starts to run long, seriously consider breaking it up.

### 7.5.1 *Contract* length isn't as important as *clause* length

"Wow, this is a long contract!" Most lawyers have heard this from clients or counterparties.

True, sometimes contracts run too long because of over-lawyering, where the drafter(s) try to cover every conceivable issue.

But focusing too obsessively on contract *length* will obscure a more-important issue: contract **readability**.

This isn't just a question of aesthetic taste. The more difficult a draft contract is to read and understand, the more time-consuming the review process, which delays the deal (and increases the legal expense).

Readability has little to do with how many pages a contract runs. Many negotiators would rather read a somewhat-longer contract, consisting of short, understandable sentences and paragraphs, than a shorter contract composed of dense, convoluted clauses.

So the better way to draft a contract is to write as many short sentences and paragraphs as are needed to cover the subject.

Even if the resulting draft happens to take up a few extra pages, your client likely will thank you for it.

### 7.5.2 A pathological example: A 415-word *sentence*

To illustrate the point, glance at the following 415-word sentence (!) — it covers not one, not two, but five separate topics (and note the abomination of "provided that" in the middle). **Note:** You don't need to *read* this sentence; just get the feel of how it looks to a reader:

> Exclusivity. The Seller covenants and agrees that for a period of ninety (90) days after the date first written above (the "*Effective Date*") or such shorter period as set forth below (as the case may be, the "*Exclusivity Period*"), none of the Seller, its affiliates or subsidiaries will, and they will cause their respective shareholders, directors, officers, managers, employees, agents, advisors or representatives not to, directly or indirectly, solicit offers for, encourage, negotiate, discuss, or enter into any agreement, understanding or commitment regarding, a possible direct or indirect sale, merger, combination, consolidation, joint venture, partnership, recapitalization, restructuring, refinancing or other disposition of all or any material part of the Company or its subsidiaries or any of the Company's or its sub-

> sidiaries' assets or issued or unissued capital stock (a "*Company Sale*") with any party other than Purchaser or provide any information to any party other than Purchaser regarding the Company in that connection; provided that, (i) for the time period commencing on the Effective Date and ending at 11:59 p.m. Central European Time on 7 July 2007 (the "*Bid Confirmation Date*"), the Parties shall work together in good faith and use commercially reasonable efforts to facilitate due diligence by Purchaser and their advisors to confirm, based on the information made available to Purchaser or their advisors prior to the Bid Confirmation Date, the intent of Purchaser to implement the Transaction pursuant to the terms of this Heads of Agreement and if Purchaser does not deliver notice to Seller of such intent by 11:59 p.m. Central European Time on (or otherwise prior to) the Bid Confirmation Date (such notice, a "*Bid Confirmation*"), then Seller shall have the right to terminate the Exclusivity Period effective as of (but not prior to) the Bid Confirmation Date by providing written notice to Purchaser by no later than 5 p.m. Central European Time on (but not prior to) the day following the Bid Confirmation Date; and (ii) if Purchaser delivers the Bid Confirmation or if such termination notice set forth in the preceding clause (i) is not given, the Seller shall have the right to terminate the Exclusivity Period effective as of (but not prior to) 11:59 p.m. Central European Time on the sixtieth (60th) day following the Effective Date by delivering written notice of such termination to Purchaser by no later than 5 p.m. Central European Time on (but not prior to) the sixty-first (61st) day following the Effective Date.

To repeat: *The above paragraph is a single sentence*; it brings to mind a savagely-funny *Dilbert* cartoon about lawyers.

> See https://dilbert.com/strip/2008-08-28.

### 7.5.3 White space is your friend

The present author used to hold to the view that it was a good idea to use a "compressed" format for contracts — with narrow margins, long paragraphs, and small print — so as to fit on fewer physical pages. This view was informed by experience that readers tended to react negatively when they saw a document with "many" pages.

But I've since concluded that if you expect to have to negotiate the contract terms, then *larger print, shorter paragraphs, and more white space:*

- will make it easier for the other side to review and redline the draft — always a nice professional courtesy that might just help to earn a bit of trust; and
- will make it easier for the parties to discuss the points of disagreement during their inevitable mark-up conference call.

A more-readable contract likely will likely get the parties to signature more quickly, and that of course, is the goal.

(At least that's the intermediate goal — ordinarily, the ultimate goal should be to successfully complete a transaction, or to establish a good business relationship, in which each party felt it received the benefit of its bargain *and would be willing to do business with the other side again*.)

### 7.5.4 Defined terms can help

The L.O.A.D.-bearing wall of words in Section 7.5.2: could be simplified by moving many of the substantive terms into definitions of defined terms, along the following lines:

**Exclusivity**

*See subdivision (h) for certain definitions.*

> Comment: This preamble anticipates the reader's question: "Where are the capitalized terms defined?" See also Section 4: for more about defined terms.

(a) During the Exclusivity Period, Seller: (i) will not engage in any Off-Limits Activity itself, and (ii) will cause each other member of the Seller Group not to engage in any Off-Limits Activity.

> Comment: This subdivision is an example of BLUF — Bottom Line Up Front — as explained at Section 7.6: .

(b) During the Exclusivity Period, the Parties will (i) work together in good faith, and (ii) use commercially reasonable efforts, to facilitate due diligence by Purchaser and Purchaser's advisors.

(c) Seller may terminate the Exclusivity Period if Purchaser does not deliver a Bid Confirmation Notice to Seller at or before the end of the Bid Confirmation Period.

> Comment: Other provisions have been omitted.

(h) Definitions:

"*Bid Confirmation Notice*" refers to written notice from Purchaser to Seller confirming Purchaser's to implement the Transaction pursuant to the terms of this Heads of Agreement, based on the information made available to Purchaser and its advisors.

"*Bid Confirmation Period*" refers to the period beginning on the Effective Date and ending at exactly 11:59 p.m. Central European Time on 7 July 2007.

> Comment: Other provisions have been omitted.

### 7.5.5 History: *Why* do drafters create wall-of-words clauses?

Even today, some contracts include long paragraphs of dense text, bringing to mind the Normandy hedgerows (*bocages*) that famously slowed the D-Day invasion of France. Why is that, when the benefits of plain language are so, well, plain?

• An obvious candidate is the classic explanation paraphrased in English as: "If I'd had more time, I'd have shortened this letter."

> The paraphrase is itself a simplification of Pascal's original, translated as "The present letter is a very long one, simply because I had no leisure to make it shorter." Blaise Pascal, Lettre XVI, in Lettres provinciales, Letter XVI (Thomas M'Crie trans. 1866) (1656), available at https://tinyurl.com/PascalLetterXVI (WikiSource.org).

• In a similar vein is the phrase, "provided, however": We can speculate that this phrase was pragmatic when lawyers dictated their contracts and had to capture thoughts that occured to them in mid-dictation. Before electronic word processing, it was no small feat to recopy a draft to incorporate revisions; even after typewriters came along, retyping was something of a pain. So saying "provided, however" might well have been the least burdensome approach — at least back then.

• Less attractively: A long paragraph of dense legalese raises the question: Was the drafter secretly hoping to use the MEGO factor ("Mine Eyes Glaze Over") to sneak an objectionable term past the reader?

• Finally: Some lawyers might flatter themselves that by using dense legalese, they'll enhance their personal prestige as High Priests of the Profession, privvy to secret legal knowledge not revealed to ordinary mortals. That seems a dubious and even risible proposition.

## 7.6 BLUF: Bottom Line Up Front

BLUF is an acronym used in the military as a guide for writing emails: *Bottom Line Up Front*. The same principle is useful in contract drafting.

> See, e.g., Kabir Sehgal, How to Write Email with Military Precision (HBR.com 2016), archived at https://perma.cc/B986-5DUY.

### 7.6.1 A statutory BLUF example

As a statutory example, this rewrite, by law professor Mark Cooney, was retweeted by legal-writing guru Bryan Garner:

*Before:*

> A person who engages in conduct proscribed under section 530 and who in the course of engaging in that conduct, possesses a dangerous weapon or an article used or fashioned in a manner to lead any person present to rea-

> sonably believe the article is a dangerous weapon, or who represents orally or otherwise that he or she is in possession of a dangerous weapon, is guilty of a felony punishable by imprisonment for life or for any term of years. If an aggravated assault or serious injury is inflicted by any person while violating this section, the person shall be sentenced to a minimum term of imprisonment of not less than 2 years.

So what exactly is the bottom line of this statutory provision?

*BLUF rewrite by Prof. Cooney:*

> **A person is guilty of a felony if**, while committing a crime under section 530, he or she:
>
> (1) possesses a dangerous weapon;
>
> (2) possesses an article used as a dangerous weapon; … *[etc.]*

(Emphasis added.)

### 7.6.2 A contract BLUF example

*Before:* Here's a contract provision that was litigated in a state court:

See Lynd v. Marshall County Pediatrics, P.C., 263 So. 3d 1041, 1044-45 (Ala. 2018).

> If any shareholder of the corporation for any reason ceases to be duly licensed to practice medicine in the state of Alabama, accepts employment that, pursuant to law, places restrictions or limitations upon his continued rendering of professional services as a physician, or upon the death or adjudication of incompetency of a stockholder or upon the severance of a stockholder as an officer, agent, or employee of the corporation, or in the event any shareholder of the corporation, without first obtaining the written consent of all other shareholders of the corporation shall become a shareholder or an officer, director, agent or employee of another professional service corporation authorized to practice medicine in the State of Alabama, or if any shareholder makes an assignment for the benefit of creditors, or files a voluntary petition in bankruptcy or becomes the subject of an involuntary petition in bankruptcy, or attempts to sell, transfer, hypothecate, or pledge any shares of this corporation to any person or in any manner prohibited by law or by the By-Laws of the corporation or if any lien of any kind is imposed upon the shares of any shareholder and such lien is not removed within thirty days after its imposition, or upon the occurrence, with respect to a shareholder, of any other event hereafter provided for by amendment to the Certificates of Incorporation or these By-Laws, *[here we finally get to the "bottom line":]* then and in any such event, the shares of this [c]orporation of such shareholder shall then and thereafter have no voting rights of any kind, and shall not be entitled to any dividend or rights to purchase shares of any kind which may be declared thereafter by the corporation and shall be forthwith transferred, sold, and purchased or redeemed pursuant to the agreement of the stockholders in [e]ffect at the time of such occurrence. The initial agreement of

> the stockholders is attached hereto and incorporated herein by reference[;] however, said agreement may from time to time be changed or amended by the stockholders without amendment of these By-Laws. The method provided in said agreement for the valuation of the shares of a deceased, retired or bankrupt stockholder shall be in lieu of the provisions of Title 10, Chapter 4, Section 228 of the Code of Alabama of 1975.

(Emphasis added.)

*After:*

> (a) **A shareholder's relationship with the corporation will be terminated**, as specified in more detail in subdivision (b), if any of the following Shareholder Termination Events occurs:
>
> (1) The shareholder, for any reason, ceases to be duly licensed to practice medicine in the state of Alabama.
>
> (2) The shareholder accepts employment that, pursuant to law, places restrictions or limitations upon his continued rendering of professional services as a physician.
>
> *[remaining subdivisions omitted]*
>
> (b) Immediately upon the occurrence of any event described in subdivision (a), **that shareholder's shares**:
>
> (1) will have no voting rights of any kind,
>
> *[Remaining subdivisions omitted]*

It should be obvious which of these is more readable.

(Emphasis added.)

## 7.7 ***Bullet-point*** **clauses can be a quicker read**

Here are two versions of the same contract clause, copied from a 2007 real-estate lease, at https://goo.gl/Qn2e9m (edgar.sec.gov), in which Tesla Motors, Inc., leased a building from Stanford University. *Which of these versions would you find easier to review?*

*Before:*

> **12.5 Indemnity.** Tenant shall indemnify, defend (by counsel reasonably acceptable to Landlord), protect and hold Landlord and Landlord's trustees, directors, officers, agents and employees and their respective successors and assigns (collectively, "Landlord's Agents"), free and harmless from and against any and all claims, liabilities, penalties, forfeitures, losses or expenses (including reasonable attorneys' and consultants' fees and oversight and response costs) to the extent arising from (a) Environmental Activity by Tenant or Tenant's Agents; or (b) failure of Tenant or Tenant's

> Agents to comply with any Environmental Law with respect to Tenant's Environmental Activity; or (c) Tenant's failure to remove Tenant's Hazardous Materials as required in Section 12.4. Tenant's obligations hereunder shall include, but not be limited to, the burden and expense of defending all claims, suits and administrative proceedings (with counsel reasonably approved by Landlord), even if such claims, suits or proceedings are groundless, false or fraudulent; conducting all negotiations of any description; and promptly paying and discharging when due any and all judgments, penalties, fines or other sums due against or from Landlord or the Premises. Prior to retaining counsel to defend such claims, suits or proceedings, Tenant shall obtain Landlord's written approval of the identity of such counsel, which approval shall not be unreasonably withheld, conditioned or delayed. In the event Tenant's failure to surrender the Premises at the expiration or earlier termination of this Lease free of Tenant's Hazardous Materials prevents Landlord from reletting the Premises, or reduces the fair market and/or rental value of the Premises or any portion thereof, Tenant's indemnity obligations shall include all losses to Landlord arising therefrom.

*After:* The above legalese can be made significantly more readable just by breaking up its wall of words into bullet points, with appropriate indentation, highlighting the separate concepts that need review.

Here's an example; I've made only minimal stylistic edits, even though a lot more could be done — at first glance it will look strange, but notice how the various potential negotiation issues are on separate lines and thus easier to review and, if necessary, revise:

> **12.5 Indemnity.**
>
> (a) Tenant shall:
>
> - indemnify,
> - defend,
>   - by counsel reasonably acceptable to Landlord,
> - protect, and hold Landlord,
>   - and Landlord's trustees, directors, officers, agents and employees,
>   - and their respective successors and assigns
>   - (collectively, "Landlord's Agents"),
> - free and harmless from and against any and all claims, liabilities, penalties, forfeitures, losses or expenses,
>   - including reasonable attorneys' and consultants' fees,
>   - along with oversight and response costs,
> - to the extent arising:

> - from Environmental Activity by Tenant or Tenant's Agents,
> - or from failure of Tenant or Tenant's Agents to comply with any Environmental Law with respect to Tenant's Environmental Activity,
> - or from Tenant's failure to remove Tenant's Hazardous Materials as required in Section 12.4.
>
> (b) Tenant's obligations hereunder shall include, but not be limited to, the burden and expense of:
>
> - defending all claims, suits and administrative proceedings,
>   - with counsel reasonably approved by Landlord,
>   - even if such claims, suits or proceedings are groundless, false or fraudulent;
> - and promptly paying and discharging, when due, any and all judgments, penalties, fines or other sums due against or from Landlord or the Premises.
>
> *[remaining text omitted]*

*More paper — so what?* To be sure, the "After" version above takes up more space than the "Before" version. But really: Who cares? These days, PDF'd signature pages and electronic signatures are the norm; for busy business people, the number of pages in a contract will usually matter far less than the time they have to wait around for legal review before signing the contract.

*Clients prefer bullet points — and counterparties don't object:* The author originally developed this bullet-point approach while reviewing and revising other parties' contract drafts for clients:

- I often encountered wall-of-words provisions like the "Before" version above.
- To help clients understand what they were agreeing to — and to reduce the chances that I'd miss something — I started breaking up the long paragraphs of dense legalese.

Turning legalese into bullet points has worked out pretty well:

- My clients have *uniformly* appreciated the enhanced readability.
- Only one counterparty or its counsel has ever objected to the bullet points.
- With that one exception, the parties have always gone on to *sign* the bullet-points version, not the other side's original wall-of-words version.

> This bullet-point approach was also inspired in part by the highly-popular Python computer-programming language: "Python's design philosophy empha-

> sizes *code readability with its notable use of significant whitespace*." Wikipedia, Python (programming language) (emphasis added).

## 7.8 Put "variable" terms in a schedule

You might know from experience that the other side is likely to want to make changes to certain contract terms. For example, a supplier who asks for net-30 payment terms might know that some customers will want net-45 or even net-60 terms.

If that's the case, then consider putting the details of such terms in a "schedule," either at the front of the document or at the beginning of the clause in question. *Example:* Consider the following excerpt from a 2007 real-estate lease between Stanford University (landlord) and Tesla (tenant):

> **COMMERCIAL LEASE**
>
> THIS LEASE is entered into as of July 25, 2007 (the "Effective Date"), by and between THE BOARD OF TRUSTEES OF THE LELAND STANFORD JUNIOR UNIVERSITY, a body having corporate powers under the laws of the State of California ("Landlord"), and TESLA MOTORS, INC., a Delaware corporation ("Tenant").
>
> **1. BASIC LEASE INFORMATION.** The following is a summary of basic lease information. Each item in this Article 1 incorporates all of the terms set forth in this Lease pertaining to such item *and to the extent there is any conflict between the provisions of this Article 1 and any other provisions of this Lease, the other provisions shall control*. Any capitalized term not defined in this Lease shall have the meaning set forth in the Glossary that appears at the end of this Lease.
>
> *Address of Premises:* 300 El Camino Real, Menlo Park, California
>
> *Term:* Five (5) years
>
> *Scheduled Date for Delivery of Premises:* August 1, 2007
>
> *Commencement Date:* August 1, 2007
>
> *Expiration Date:* July 31, 2012
>
> *Base Rent:*
>
> | | |
> |---|---|
> | Year One: | $60,000 ($5,000 per month) |
> | Year Two: | $90,000 ($7,500 per month) |

| | |
|---|---|
| Year Three: | $120,000 ($10,000 per month) |
| Year Four: | $165,000 ($13,750 per month) |
| Year Five: | $165,000 ($13,750 per month |

This can:

- give the business people an "executive summary" of terms in which they're likely to be especially interested;
- speed up review and editing of the draft; and
- in the future, make it easier and safer to re-use the contract as the starting point for a new contract, with less risk of having old terms appear in the new contract — as an embarrassing example, see the screw-up in the Brexit agreement summarized at § 3.2).

> (This principle is an example of the rule: **R.O.O.F**: Root Out Opportunities for F[oul]ups.)

## 7.9 Use charts and tables?

Instead of long, complex narrative language, use charts and tables. Here's an example of the former:

> If it rains less than 6 inches on Sunday, then Party A will pay $3.00 per share, provided that, if it it rains at least 6 inches on Sunday, then Party A will pay $4.00 per share, subject to said rainfall not exceeding 12 inches, [etc., etc.]

Here's the same provision, in table form:

> Party A will pay the amount stated in the table below, based on how much rain falls on Sunday:
>
| **AMT. OF RAIN** | **PAYMENT DUE** |
|---|---|
| Less than 6 inches | $3.00 per share |
| At least 6 inches<br>but less than 12 inches | $4.00 per share |

For an example "in the wild," see § 3.12 of this agreement.

Or even the following, in a bullet-point format:

> Party A will pay the amount stated in the table below, based on how much rain falls on Sunday:
>
> - *Amount of rain:* Less than 6 inches.
> *Payment due:* $3.00 per share
> - *Amount of rain:* At least 6 inches but less than 12 inches.
> *Payment due:* $4.00 per share

Which one would you rather read if you were reviewing the contract?

## 7.10 Use industry-standard terminology

When you're drafting a contract, you'll want to try to avoid coining your own non-standard words or phrases to express technical or financial concepts. If there's an industry-standard term that fits what you're trying to say, use that term if you can. Why? For two reasons:

- First, someday you might have to litigate the contract, and so:
    - You'll want to make it as easy as possible for the judge (and his- or her law clerk) and the jurors to see the world the way you do. In part, that means making it as easy as possible for them to understand the contract language.
    - The odds are that the witnesses who testify in deposition or at trial likely will use industry-standard terminology. So the chances are that the judge and jurors will have an easier time if the contract language is consistent with the terminology that the witnesses use—that is, if the contract "speaks" the same language as the witnesses.
- Second, and perhaps equally important: The business people on both sides are likely to be more comfortable with the contract if it uses familiar language, which could help make the negotiation go a bit more smoothly.

## 7.11 Include examples and sample calculations?

Your contract might contain a complex formula or some other particularly tricky provision. If so, consider including a hypothetical example or sample calculation to "talk through" how the formula or provision is intended to work, such as in the following:

> a. *Day* refers to a calendar day, as opposed to a business day.

b. A period of X days:

1. begins on the specified date, and

2. ends at exactly 12 midnight (see subdivision c concerning time zones) at the *end* of the day on the date X days later.

- *Example:* Suppose that a five-day period begins on January 1 — that period ends at exactly 12 midnight at the end of January 6.

c. For purposes of subdivision b, the term *12 midnight* refers:

a. to local time if only one time zone is relevant,

b. otherwise, to the *latest* occurrence of 12 midnight *on the date in question*.

- *Example:* Suppose that both California time and Tokyo time are relevant; in that case, 12 midnight at the end of the day on January 1 refers to 12 midnight at the end of the day on January 1 *in California* (when it would be mid-afternoon on January **2** in Tokyo).

(These examples could be put in footnotes, as discussed in the next section.)

In one litigated case, the drafters of $49 million of promissory notes would have been well served to include a sample calculation to illustrate one of their financial-term definitions. The court specifically mentioned particular calculations that the lender had submitted with its motion for summary judgment; if the promissory-note drafters had thought to include one or two sample calculations in the body of the contract itself, then by being forced to work through those sample calculations, the drafters and their client(s) might well have spotted the problems with the promissory-note language in time to fix it before signature.

> See BKCAP, LLC v. CAPTEC Franchise Trust 2000-1, 572 F.3d 353, 355-57, 359 (7th Cir.2009) ("BKCAP-1") (reversing and remanding summary judgment) *after remand*, 688 F.3d 810 (7th Cir. 2012) (affirming judgment in favor of borrowers after bench trial).

## 7.12 Add explanatory footnotes?

Suppose that, after intense negotiations, a particular contract clause ends up being written in a very specific way. Consider including a footnote at that point in the contract, explaining how the language came to be what it is. Future readers — your client's successor, your client's trial counsel, a judge — might thank you for it.

*Example:* In a prior life, the present author was vice president and (solo) general counsel of a newly-public software company that, as outside counsel, I'd helped the founders to start.

- Our standard enterprise license agreement form was extremely customer-friendly (this was intentional, to help us get to signature sooner), but at first I still had to spend a lot of time explaining to customers' lawyers *why* the agreement form included certain terms.
- To save negotiation time, I added a fair number of explanatory footnotes to our license-agreement form. That seemed to reduce, by quite a lot, the amount of time needed for "legal" negotiations.

Needless to say, our business people weren't unhappy about getting deals to signature sooner.

And interestingly, customers' lawyers hardly ever asked us to delete the footnotes before contract signature — which means that if the contract were ever litigated (which never once happened), the footnotes would be available to be read by opposing counsel; the judge's law clerk; the judge him- or herself; and one or more of the jurors — and that would be no bad thing, yes?

Sure, someday in litigation you might wish you hadn't said what you did in the footnotes — but that could happen with *any* language in the contract. What's important here is that the overwhelming majority of contracts never see the inside of a courtroom. So, *on balance* the client gets more *overall* business benefit from including footnotes if doing so will help get the client's contracts to signature sooner.

## 7.13 Exercises and discussion questions

### 7.13.1 Basic questions

1. Who are some of the people who might someday read: (i) the *draft* contract; (ii) the *signed* contract — and what will they likely be hoping to accomplish?

2. FACTS: MathWhiz's CEO asks you to draft a short contract in which MathWhiz will do some data-analysis for a longtime client.

    - The CEO says that she and her contact at the client have agreed on all the details in a series of Zoom calls.
    - The CEO has drafted a detailed "term sheet," with bullet points outlining the agreed business- and technical details; her client contact has reviewed the term sheet and said it's fine.

- The client contact doesn't want to get his company's lawyers involved, so the MathWhiz CEO has asked you whether "the contract" could be drafted as just a short email that she will send to the client contact, with the term sheet attached.

- QUESTION: What do you advise the MathWhiz CEO, and why? *How* would you advise her, and why?

3. True or false: Contract drafters should avoid including explanations of particular terms. EXPLAIN.

4. FACTS: You're drafting a contract for MathWhiz; the company's CEO tells you there's a fair chance that the contract might be litigated in the not-too-distant future. QUESTION: How might the Strunck & White injunction, "Omit needless words," apply in this situation?

5. MORE FACTS: Continuing with #4, MathWhiz's CEO also thinks that the other party to the contract is likely to be acquired in the next year or so — by whom exactly, the CEO doesn't know — and that it'd likely be an "acqui-hire" in which many of the other party's senior executives and -managers would be let go (with their stock options and a severance package) as no longer needed. QUESTION: What if anything might you do differently in drafting the contract?

6. What are the *two* essential components of a contract drafter's mission?

7. FACTS: You are drafting a contract for MathWhiz and are getting ready to send it to MathWhiz's CEO, Mary Marvelous. QUESTION: Name *two* reasons that *Mary* will likely prefer that the contract be written in plain language.

8. MORE FACTS: MathWhiz is considering filing a lawsuit for breach of another contract that you *didn't* draft. The breached provision is a "wall of words" that's full of legalese. QUESTION: Name *two* reasons that MathWhiz's *trial counsel* might wish that the breached provision had been written in plain language.

9. In the context of contract drafting, what's a "L.O.A.D."?

10. What's one of the most important ways of avoiding being a L.O.A.D.?

11. Based on whatever experience you've had so far — personal and/or professional — would *you* prefer to review a contract with (i) fewer pages with dense paragraphs, or (ii) more pages but shorter paragraphs and more white space? EXPLAIN.

12. What does BLUF mean?

13. What's "the MEGO factor"?

14. Name *two* advantages of putting a contract's key business details into a schedule, perhaps at the front of the contract.

### 7.13.2 Exercise: Stanford-Tesla lease intro

Refer again to the Stanford-Tesla lease at § 7.8:

1. Is "Commercial Lease" the proper term, or should it be "Commercial Lease *Agreement*"? *(Hint: Look up the definition of* lease *in Black's Law Dictionary.)*

2. Why state that the Lease is entered into "as of July 25, 2007"?

3. Why do you think the names of the parties are capitalized?

4. What might be some of the pros and cons of including this kind of "Basic Lease Information" at the beginning of the agreement document, instead of including it "in-line" in the appropriate section(s) of the agreement?

5. To what extent is the "Each item in this Article 1 incorporates …" worth including?

6. What could go wrong with the italicized portion, "to the extent there is any conflict …"?

7 Note the mention of the Glossary in the last sentence of the first paragraph — where are some other places to include definitions for defined terms? (Hint: See § 4.)

1. Any comments about the way the "*Term:* Five (5) years" portion is stated? How about the way that the Base Rent amounts are stated?

# Chapter 8 Ambiguity and its dangers

In a contract, ambiguity can be seriously-bad news; many lawyers would surely agree that ambiguous contract language is one of the top sources of legal trouble for parties doing business together. The *inadvertent* drafting of ambiguous terms is an occupational hazard for contract drafters.

## 8.1 What *is* "ambiguity" — and why is it bad?

A contract term is *ambiguous* if it is susceptible to **two or more *plausible* interpretations** — and when that happens, the contract term can cause major difficulties for the parties. An ambiguous term in a contract lets one or both parties fight about just what meaning should be ascribed to that term.

This is a big problem because if a contract provision is ambiguous, and the parties get into a lawsuit that turns on the meaning of the provision, then in the U.S., *the court is not allowed to grant a quick summary judgment on undisput-*

*ed facts*; instead, the court must conduct a trial so that the trier of fact (a jury, or perhaps the judge) can find facts as needed to determine the *proper* meaning of the disputed provision.

As the Texas supreme court explained:

> A contract is not ambiguous if the contract's language can be given a certain or definite meaning.
>
> But if the contract is subject to two or more reasonable interpretations after applying the pertinent construction principles, [then] the contract *is* ambiguous, *creating a fact issue* regarding the parties' intent.
>
> *Summary judgment is not the proper vehicle* for resolving disputes about an ambiguous contract.

Plains Explor. & Prod. Co. v. Torch Energy Advisors Inc., 473 S.W.3d 296, 305 (Tex. 2015) (formatting modified, citations omitted).

In other words, if a contract is ambiguous, then the parties must subject themselves to a full-blown trial (if they're lucky, a trial on just that one issue), *with all the attendant burden, expense, and uncertainty*.

And there might well be a lot of money riding on the jury verdict; for example, in the case just quoted, the losing party ultimately missed out recovering the roughly *$44 million* that it had claimed it was owed under the contract in suit.

Incidentally, the supreme court also noted a generally-accepted point in the law: "Mere disagreement over the interpretation of an agreement does not necessarily render the contract ambiguous."

*Id.* (citation omitted).

As another high-stakes example, consider a Fifth Circuit case in which an offshore drilling rig was severely damaged by fire while in drydock in Galveston for maintenance. The drilling rig's owner and the drydock owner disputed which of the two parties had had "control" of the rig at the time of the fire. The intended meaning of "control" was important because under the parties' agreement, if the drilling rig's owner had control at the time of the fire, then the drydock owner was not financially responsible for the fire damage. Needless to say, that issue was hotly disputed (if you'll pardon the expression).

The trial court held that the term "control" was unambiguous, and granted summary judgment that, *on the undisputed facts*, the rig owner, not the dock owner, had been in control at the time of the fire. The appeals court affirmed; thus, the parties were spared the expense, inconvenience, and uncertainty of a trial on the issue of control of the rig.

See Offshore Drilling Co. v. Gulf Copper & Mfg. Corp., 604 F.3d 221 (5th Cir. 2010) (affirming summary judgment in relevant part).

Of course, the drilling-rig owner would certainly have preferred to go to trial and take its chances, versus losing on summary judgment without ever getting a shot at persuading a jury. But for the drydock owner, *not* having to go to trial was most assuredly a win in its own right.

Spotting and fixing ambiguities in a contract before signature should be a prime goal of all contract drafters and reviewers. "President and later Chief Justice Taft got it right, though in the negative: *'Don't* write so that you can be understood; write *so that you can't be misunderstood*.'"

> Gerald Lebovits, Free at Last from Obscurity: Achieving Clarity, 96 Mich. B.J. 38 (May 2017), SSRN: https://ssrn.com/abstract=2970873 (emphasis added, footnote omitted).

## 8.2 Example: A date-related ambiguity

Here's a simple example of an ambiguity: Suppose that your client MathWhiz has signed a lease for office space, where it is the tenant. Now suppose that the lease says the following:

> Tenant will vacate the Premises no later than 12 midnight **on** December 15; Tenant's failure to do so will be a material breach of this Agreement.

> Bold-faced emphasis added.

Now suppose that a MathWhiz representative calls you up and says that they can't move out before **10:00 a.m.** on December 15. QUESTION At *that* time, on *that* day, would MathWhiz still have 14 hours left in which to finish moving out? Or would MathWhiz already in material breach because it didn't move out by the *previous* midnight? In other words, does "by midnight" mean before midnight at the *start* of the day, or before midnight at the *end* of the day?

> This ambiguity illustrates a useful drafting principle: *W.I.D.D. – When In Doubt, *De-fine*!*

Ripple-effect business complications can arise from such ambiguities — in the December 15 example above, the landlord might have already re-leased the premises to a new tenant, with a promise that the new tenant can move in on that date.

QUESTION: How would you rewrite the "Tenant will vacate the Premises …." sentence to resolve this ambiguity?

## 8.3 How do courts "construe" ambiguous terms?

Here's a quick recap of some basic principles of "construing" — that is, interpreting — ambiguous contract terms:

• As noted above, in a lawsuit, the judge normally makes the first pass at determining the meaning of a disputed provision; **if the provision is unambiguous, then the judge will *declare* the provision's meaning** *without* the need for a trial on that particular point.

(Conceivably, the appellate court might have a different view: It might conclude that the provision is indeed ambiguous, in which case the matter might well be remanded for a trial to determine the provision's meaning.)

• If all else fails — if the usual contract-interpretation principles don't produce a definitive answer for what a contract provision means — then the judge will rule that provision is ambiguous.

• **When a provision is ambiguous, the case must** (usually) **be tried**, and the trier of fact (usually, the jury) gets to decide what the parties are deemed to have had in mind; they will often do this by looking to extrinsic evidence under the parol evidence rule, such as witness testimony by the people who negotiated the contract term(s) in question.

• If a trial court hears the witnesses and makes a determination what the parties are deemed to have intended in drafting the ambiguous provision, then the appellate court isn't likely to overrule that determination (at least in the United States). The Seventh Circuit explained:

> The district court's job was to look at extrinsic evidence and determine what the agreement was. It did that.
>
> Our job is to decide if the district court's view of that evidence was clearly erroneous (or legally wrong). …
>
> The argument, '*The Borrowers' position was supported by the evidence presented at trial but our interpretation is way, way better*' is a nonstarter.
>
> We are looking to correct error, not reward elegance.
>
> BKCAP, LLC v. CAPTEC Franchise Trust 2000-1, 688 F.3d 810, 813-14 (7th Cir. 2012) (emphasis in original, extra paragraphing added).

Likewise, the Texas supreme court summarized the general ground rules for interpreting contract language (which I've recast into a bullet-point format):

> Absent ambiguity, contracts are construed as a matter of law. *[That is, the trial judge, not the jury, construes the contract, and the appeals court is free to overrule the trial judge]*.
>
> In construing a written contract, **our primary objective** is to ascertain the parties' true intentions as expressed in the language they chose.

> We construe contracts from a utilitarian standpoint bearing in mind **the particular business activity** sought to be served, and **avoiding unreasonable constructions** when possible and proper.
>
> To that end, we consider **the entire writing** and giving effect to all the contract provisions so that **none will be rendered meaningless**.
>
> No single provision taken alone is given controlling effect; rather, each must be considered **in the context** of the instrument as a whole.
>
> We also give words their plain, common, or **generally accepted meaning** unless the contract shows that the parties used words in a technical or different sense.
>
> While **extrinsic evidence** of the parties' intent is **not** admissible to **create** an ambiguity, the contract may be read in light of the circumstances surrounding its execution to determine whether an ambiguity exists. Consideration of the surrounding facts and circumstances is simply an aid in the construction of the contract's language and has its limits.
>
> The rule that extrinsic evidence is not admissible to create an ambiguity obtains even to the extent of prohibiting proof of circumstances surrounding the transaction when the instrument involved, by its terms, *plainly and clearly discloses the intention of the parties*, or is so worded that *it is not fairly susceptible of more than one legal meaning* or construction.

Plains Explor. & Prod. Co. v. Torch Energy Advisors Inc., 473 S.W.3d 296, 305 (Tex. 2015) (formatting modified, citations omitted).

## 8.4 Courts apply specific rules of interpretation

### 8.4.1 Some basic rules

Courts often look to specific rules of interpretation such as the following:

For additional, completely-optional background reading, see generally, e.g.: Vincent R. Martorana, A Guide to Contract Interpretation (ReedSmith.com 2014); James J. Sienicki and Mike Yates, Contract interpretation: how courts resolve ambiguities in contract documents (Lexology.com 2012: https://goo.gl/ZGkwJu).

• Specific terms normally take precedence over general terms.

• A term stated earlier in a contract is given priority over later terms.

• The rule of the last antecedent — for example: A federal criminal statute included a mandatory ten-year minimum sentence in cases where the defendant had previously been convicted of "aggravated sexual abuse, sexual abuse, or abusive sexual conduct involving a minor or ward." The Supreme Court held that the minor-or-ward qualifier applied only to abusive sexual conduct, not to

sexual abuse; as a result, a defendant was subject to the ten-year mandatory minimum sentence for sexual abuse against an adult.

> Lockhart v. United States, 577 U.S. _, 136 S. Ct. 958, 962 (2016).

• BUT: The series-qualifier principle might weigh against the rule of last antecedent. Dissenting in the *Lockhart* case just cited, Justice Kagan argued: "Imagine a friend told you that she hoped to meet 'an actor, director, or producer involved with the new Star Wars movie.' You would know immediately that she wanted to meet an actor from the Star Wars cast—not an actor in, for example, the latest Zoolander."

> *Id.*, 136 S. Ct. at 969 (Kagan, J., dissenting).

### 8.4.2 *Contra proferentem*: "Against the offerer"

[Note to students: Be sure to learn how to spell *proferentem*!]

The *contra proferentem* principle of contract interpretation holds that **if** an ambiguity in particular contract language cannot be resolved by other conventional methods — e.g., by consulting other language in the contract and/or by considering extrinsic evidence such as course of dealing and usage in the trade — then the ambiguity should be resolved against the party that drafted the ambiguous language and thus is "to blame" for the problem. (If a contract provision is not ambiguous, then *contra proferentem* won't come into play in the first place.)

The (U.S.) Supreme Court explained the concept: "Respondents drafted an ambiguous document, and they cannot now claim the benefit of the doubt. The reason for this rule is to protect the party who did not choose the language from an unintended or unfair result."

> Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 62-63 (1995) (reversing 7th Circuit) (citations and footnotes omitted). *Contra proferentem* is roughly analogous to the baseball rule, tie goes to the runner. It gives drafters an incentive to draft clearly, because as between the drafter of ambiguous language, on the one hand, and the "innocent" other party, it's the drafter that must bear the consequences of the ambiguity. *Additional, optional background reading:* • the Wikipedia article Contra proferentem; • Michelle E. Boardman, *Contra Proferentem*: The Allure of Ambiguous Boilerplate, 104 Mich. L. Rev. 1105 (2006); • Tal Kastner & Ethan J. Leib, Contract Creep, 107 Geo. L. Rev. 1277, 1298-1302 (2019).

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See generally:

- the Wikipedia article Contra proferentem

- Michelle E. Boardman, *Contra Proferentem*: The Allure of Ambiguous Boilerplate, 104 Mich. L. Rev. 1105 (2006)
- Tal Kastner & Ethan J. Leib, Contract Creep, 107 Geo. L. Rev. 1277, 1298-1302 (2019)

**Caution:** Disclaiming *contra proferentem* can cause problems: Suppose that a court or arbitrator concluded that there was no way to resolve an ambiguity in a contract, other than by applying the *contra proferentem* principle — but the parties had agreed that *contra proferentem* was not to be used (such as in Tango Clause 22.37 - Contra Proferentem Disclaimer). The results in that situation might be unpredictable:

- The tribunal might disregard the *contra proferentem* prohibition and apply the principle to resolve the ambiguity; or
- The tribunal might rule that the ambiguous provision could not be enforced — which in some circumstaces might jeopardize the enforceability of the entire contract.

(Hat tip: Jonathan Ely, in a comment in a LinkedIn group discussion (group membership required).)

**Pro tip:** Some drafters might be tempted to *prohibit* the use of the *contra proferentem* principle in interpreting contract terms. That's not the best "look": Parties to a contract generally can't *prohibit* a court from applying a particular legal doctrine, they can only *request* that the court not do so.

### 8.4.3 *Ejusdem generis*

Under the principle of *ejusdem generis*, "if a law refers to automobiles, trucks, tractors, motorcycles, and other motor-powered vehicles, a court might use *ejusdem generis* to hold that such vehicles would not include airplanes, because the list included only land-based transportation." Nolo's Plain-English Law Dictionary (law.cornell.edu); see also the commentary about *ejusdem generis* ("eh-USE-dem GENerous").

Drafters can avoid application of *ejusdem generis* by using the term "including *but not limited to*" (emphasis added). As then-Judge Alito pointed out: "By using the phrase 'including, but not limited to,' the parties unambiguously stated that the list was not exhaustive. … [S]ince the phrase 'including, but not limited to' plainly expresses a contrary intent, the doctrine of *ejusdem generis* is inapplicable."

> Cooper Distributing Co. v. Amana Refrigeration, Inc., 63 F.3d 262, 280 (3d Cir. 1995) (citations omitted). To like effect is Eastern Air Lines, Inc. v. McDonnell Douglas Corp., 532 F.2d 957, 988-89 (5th Cir. 1976); see also Robert E. Scott and George G. Triantis, Anticipating Litigation in Contract Design, 115 Yale L.J. 814 (2006): "Contracting parties can avoid a restrictive interpretation under the *ejusdem*

*generis* rule by providing that the general language includes but is not limited to the precise enumerated items that either precede or follow it." *Id.* at 850 & n.100, *citing Cooper Distributing and Eastern Airlines*.

## 8.5 The W.I.D.D. Rule: When In Doubt, Define!

Savvy contract drafters prefer not to roll the dice about whether a court will apply the above principles in a way that favors the drafter's client. So: To repeat from above, an extremely-useful general principle of contract drafting is, **W.I.D.D. – When In Doubt, *Define*!**

## 8.6 The A.T.A.R.I. Rule

What to do about an ambiguity in a contract draft might well depend on the circumstances:

• On the one hand, unambiguous language is generally a Good Thing, because it tends not to result in disputes between the parties about the language's meaning — although that certainly isn't a universal rule.

And if a dispute *does* arise over an unambiguous provision, the judge will often decide the case quickly, e.g., on a motion to dismiss on the pleadings or a motion for summary judgment.

That's because in the U.S., as noted above, the interpretation of an unambiguous contract term is generally a "question of law," that is, the proper interpretation will be decided by the trial judge (subject to review by the appeals court) and not by a jury.

• In contrast: When a contract is ambiguous, **creative litigation counsel, exercising 20-20 hindsight**, can be quite skilled at proposing meanings that favor their clients.

Ambiguities in a contract aren't necessarily fatal, because the law has rules for resolving them, as discussed above.

But an expensive- and time-consuming *trial* is likely to be needed to determine just what the parties had in mind.

To borrow a phrase from a former student in a different context: "That's a conversation we don't want to have."

| When in doubt, A.T.A.R.I. - Avoid the Argument: Rewrite It. |
|---|

**Did *your side* draft the ambiguous language?** If you or one of your colleagues drafted the ambiguous language, then you'll very likely want to fix the ambiguity, especially if the draft hasn't yet been sent to the other side. That's because under the doctrine of *contra proferentem*, a court might resolve the ambiguity *in favor of the other side* because your side was responsible for the ambiguity.

> See § 8.4.2 for a more-extensive discussion of the doctrine of *contra proferentem*.

**What if *the other side* drafted the ambiguous language?** Now consider these points:

– If *the other side* drafted the ambiguous language, then you might not want to say anything about it, in the hope that *contra proferentem* would result in an interpretation favorable to your client.

> As noted above: See § 8.4.2 for a more-extensive discussion of the doctrine of *contra proferentem*.

– That could be especially true if your client doesn't have the superior bargaining position: If you call the other side's attention to the ambiguity, the other side might wake up and ask for something that's even worse for your client than living with the ambiguity, because you "kicked the sleeping dog" as discussed in § 11.7.1. That might be another reason to keep silent about the ambiguity.

– BUT: If later the other side can show that you noticed, *but failed to raise*, an ambiguity created by the other side's drafter, then the other side might try to argue that *you waived application of* contra proferentem by "laying behind the log."

– AND: No matter what, if you *don't* ask the other side to correct an ambiguity they created, then you might be setting up your client for an expensive, burdensome, future fight — a fight that perhaps might have been avoided with clearer drafting.

So what to do?

- The Check-In Rule applies here (see § 6.3): Check in with the partner and/or the client about this, and have a recommendation with reasons.
- But the A.T.A.R.I. Rule (see § 8.6) might be more important.

## 8.7 *Vagueness* is a type of ambiguity – what to do about it?

As one type of ambiguity, a term is *vague* if its *precise* meaning is uncertain.

• A classic example is the term *tall*: If you say that someone is tall, you could be referring to that a third-grader who is tall *for his- or her age* but is still very-much shorter than the general adult population.

• Another classic example of vagueness is the word *cool*; depending on the season and the locale, the term could refer to a wide range of temperatures. For example, in Houston in August a mid-day temperature of 80ºF would be regarded as (comparatively) cool, whereas in Point Barrow, Alaska, the same temperature at that time would likely be thought of as a real scorcher.

(Of course, as any parent in an English-speaking family knows, the word *cool* could also be ambiguous — in the sense of having multiple possible meanings — in addition to being vague.)

Let's look at another example, this time a silly one. Consider the following provision in a contract for a home caregiver:

> Nurse will visit Patient's house each day, check her vital signs, and give her cat food.

The sentence above is *ambiguous*, in that conceivably it might take on any of three meanings:

1. Nurse is to put a bowl of food down for Patient's cat each day.

2. Nurse is to *deliver* cat food to Patient when Nurse visits.

3. Nurse is to *feed* cat food to Patient.

> OK, *that* one might be a stretch.

In addition, the sentence above might also be *vague* if it turned out that Patient had more than one cat.

Moreover, meanings #1 and #2 above are vague in another sense as well: The term *cat food* encompasses wet food, dry food, etc.

*Vagueness is not necessarily a bad thing.* Parties might be confident that, if a question ever arises, it'll be clear what was intended by, say, the term *reasonable efforts*.

So here's a rule of thumb: **Vagueness is not always worth fixing.**

But a vague term **is** always worth taking a look at to see if it should be replaced by a more-precise term.

## 8.8 Special case: D.R.Y. - Don't Repeat Yourself

Stating a term more than once in a contract can cause severe problems if:
(i) a term is revised during negotiation, and
(ii) the revision is not made in every place that the term occurs.

Just this type of mistake once cost a bank $693,000: • The bank sued to recover $1.7 million from defaulting borrowers and their guarantor. In the lower court, the bank won a summary judgment. • Unfortunately for the bank, the loan documents referred to the amount borrowed as "one million **seven thousand** and no/100 ($1,700,000.00) dollars" (capitalization modified, emphasis added). The appeals court held that, under standard interpretation principles, *the words*, not the numbers, controlled; thus, the amount guaranteed was only $1.007 million, not $1.7 million.

> See Charles R. Tips Family Trust v. PB Commercial LLC, 459 S.W.3d 147 (Tex. App.–Houston [1st Dist.] 2015) (reversing and remanding summary judgment in favor of bank).

(You probably wouldn't want to be the junior associate or paralegal who oversaw the document preparation in that case.)

Likewise, in a Delaware case: • A contract's termination provision allowed termination if a material breach was not cured within "**fifteen (30) days**" after notice of the breach. • The breaching party refused to cure the breach, so the non-breaching party terminated the agreement shortly after **15 days** had elapsed from the notice of breach. • The breaching party had a change of heart after receiving the notice of termination and proceeded to cure the breach. The court said, in effect, "sorry, too late" — because the word *fifteen* took precedence over the numerals *30*.

> See Fetch Interactive Television LLC v. Touchstream Technologies, Inc., No. 2017-0637-SG, slip op. at 52, 54 (Del. Ch. Jan. 2, 2019) (memorandum of post-trial decision) (emphasis added).

Another case: • One of the author's clients was contemplated being acquired. • A potential acquiring party proposed a confidentiality agreement (a.k.a. nondisclosure agreement a.k.a. NDA). The text said, in part: "provided, however, that in the event that a court of law shall determine that a fixed duration of survival is required, said [confidentiality] obligations shall survive for a period of **five (3)** years from the later of the following: the date of termination or expiration of this Agreement, or the date that either party notifies the other party that it has decided not to enter into the transaction or agreement contemplated by the parties." In that case I fixed the inconsistency even though I hadn't created it, for reasons discussed in § 8.6.

Here's an example of how to do it better:

> ✘ Bob will pay Alice one hundred thousand dollars ($100,000.00) for the House, with 50% due upon signing of this Agreement.

> ✓ Bob will pay $100,000 for the House, with 50% due upon signing of this Agreement.
>
> Note how the ".00" is omitted because it's not needed.

Sometimes, though, repetition can be used (cautiously) to emphasize a point — after all, *the drafter's mission is still to educate and persuade* (see § 7.2), not merely to slavishly follow drafting guidelines.

## 8.9 Optional further reading about ambiguity

Some amusing examples of ambiguity can be read at the Wikipedia article on Syntactic ambiguity, at https://goo.gl/6zmrH5

See also numerous categorized case citations by KPMG in-house attorney Vince Martorana, at A Guide to Contract Interpretation (ReedSmith.com 2014).

## 8.10 Exercises & discussion questions

1. A contract term is ambiguous when the term is amenable to [BLANK].

2. In litigation, an ambiguity in a contract provision will be resolved by A) the judge; B) the jury; C) one or more other officials.

3. Consider the following sentence: "Alice says that Bob is cold." Is this more likely to be considered *vague*, *ambiguous*, or both?

4. Consider the following sentence: "Alice says that Bob's forehead feels warm." Is this more likely to be considered vague, ambiguous, or both?

5. What is a principal danger of an ambiguous contract term?

6. FACTS: In a contract draft prepared by The Other Side, you see a term that's vague — it says that your client must pay The Other Side a certain amount by a certain date, but doesn't specify *the time of day* for that deadline. QUESTION: Is this worth asking The Other Side to fix? Discuss your reasoning.

7. MORE FACTS: In this contract, your client is located in Vancouver, Canada and The Other Side (which drafted the contract) is located in Houston. The contract states that the amount your client must pay is $1 million. QUESTION: Is this an issue? If so, is it worth burning up negotiation time by asking The Other Side to fix it? Discuss your reasoning.

8. MORE FACTS: In the above situation, your client really wants to get the contract to signature as soon as possible, like yesterday. You've tentatively concluded that it's not worth raising either of the above points (time of day

and amount due) with The Other Side. QUESTION: To be on the safe side and keep your malpractice-insurance carrier happy, what might you want to do about these points *before* sending your markup to The Other Side?

9. If all else fails in trying to interpret a contract provision, what Latin maxim will courts often follow, and what does it mean?

10. The term "12 midnight on January 21" refers to the next minute after 11:59 p.m. on: A) January 20; B) January 21; C) can't tell from this text alone.

11. The Latin phrase for "against the offereor" is [BLANK].

## 8.11 Ambiguity-spotting drills

1. TEXT, from The Kinks' famous song Lola (play the relevant clip on YouTube): "*Well I'm not the world's most masculine man | But I know what I am and I'm glad I'm a man | And so is Lohhh-lahhh ….*." QUESTION: When the artists sing, "And so is Lola," *what* exactly is Lola? EXERCISE: How that lyric line could be clarified? (Don't worry about rhyme or meter.)

2. TEXT, from a Maureen Dowd column in the NY Times, March 5, 2016: "Like Bill Clinton, Trump talks and talks to crowds. … *[H]e creates an intimacy even in an arena that leaves both sides awash in pleasure.*" (Emphasis added.) QUESTION: What, exactly, leaves both sides awash in pleasure? How could this be clarified?

3. TEXT, from Donald Trump: "My daughter, Ivanka, just arrived in South Korea. We cannot have a better, or smarter, person representing our country." From Jonathan Chait: "That second sentence can really be read a couple ways." *[DCT comment: It'd be better to say "a couple of ways."]* From Gary Schroeder: "Also, the use of commas implies that she is his only daughter."

4. TEXT, from a tweet: "I've sworn to defend and uphold our Constitution 11 times." QUESTION: What exactly does "11 times" refer to — defending and upholding the Constitution 11 times, or *swearing* to do so? EXERCISE: Rewrite to clarify.

5. TEXT, adapted from an arbitration award I was writing (and caught myself): "Ms. Doe and her coworker Jane Roe were separately interviewed by John Doe and Becky Bow." QUESTION: How many separate interviews were conducted — two? four? EXERCISE: Rewrite to clarify.

6. TEXT, from a tweet encouraging attendance at an anti-lockdown protest in Maine: "[T]here will be a caravan around the Capitol … Monday. … Remain in your vehicles but masks, bandanas, flags and signs on cars are encouraged."

QUESTION: In your view, why are caravaners being encouraged to put masks and bandanas on cars? QUESTION: How could this be rewritten to clarify?

7. TEXT, from an obituary: "Pamela went to heaven surrounded by family whom she loved …." QUESTION: What possibilities does this line evoke in your minds?

8. TEXT, from this tweet by ABC Channel 13 (Houston): "Suspected Houston-area pedophile accused of assaulting 16-year-old arrested in Canada." QUESTION: What are some possible interpretations of this tweet? How could it be clarified?

9. TEXT: Spotted in a Facebook group: "My eight year old just asked me if Bingo is the name of the farmer or the dog. And now I am questioning everything I thought I knew about life." (Credit: @whitneyhemsath.)

10. TEXT, from Erin Johnston, Not All at Once, And Not All Alone, ABA JOURNAL, Nov. 2018, at 14: "My success *[as a Kirkland & Ellis litigation partner]* has not been the result of a perfectly-executed master plan. But I can say that I have unapologetically asked for what I needed and was pleasantly surprised by the responses I received. No one above me assumed they knew what I wanted, or that what I wanted would always be the same. *At times I turned down opportunities to avoid travel or to focus on my family*; other times I chose to take that trip or work long hours. …" (Emphasis added.) QUESTION: What are two possible meanings of the italicized portion? QUESTION: How could the italicized portion be clarified?

11. Ambiguous: This sign. More clear: This sign.

12. TEXT, from a presidential tweet of April 3, 2017: "Such amazing reporting on unmasking and the crooked scheme against us by @foxandfriends. …" (Hat tip: Chris Richardson.) QUESTION: What are two possible interpretations of this tweet?

13. TEXT, from a Facebook post by Stanford law professor Mark Lemley: "Things I appear to like more than my Facebook friends: 1. Pants." QUESTION: What are the two possible meanings here?

14. TEXT, from this BBC.com article: "Nestle has announced that it will pay Starbucks $7.1bn (£5.2bn) to sell the company's coffee products." QUESTION: QUESTION: Which company will sell which company's coffee? How could this be clarified?

15. TEXT, from a BBC News tweet: "Belgium court clears three doctors accused of unlawfully poisoning a woman whose life they helped to end in landmark trial." QUESTION: What exactly happened at the "landmark trial"?

16. TEXT: "A hypothetical leak could occur, he said, if officials believed Clinton was *not being prosecuted for political reasons*." (Emphasis added.) (From a Politico piece titled FBI could leak Clinton email investigation, Grassley

warns.) QUESTION: There are two possible meanings of the italicized portion of the above sentence. Discuss.

17. TEXT, from an article in *The Guardian*: "There will be plush lecture theatres with thick carpet, perhaps named after companies or personal donors." ( Martin Parker, Why we should bulldoze the business school, The Guardian, Apr. 27, 2018 (https://perma.cc/F5N6-46RE).) QUESTION: *What*, exactly, is named after companies or personal donors? QUESTION: How could this sentence be rewritten to clarify it?

18. TEXT, from an arbitration award that the present author was writing (and caught myself): "Ms. Doe and her coworker Jane Roe were separately interviewed by Human Resources manager John Doe and Becky Bow." QUESTION: How many people were interviewed, by how many people?

19. TEXT, from a Hacker News discussion: "You should only short term trade with your 401k." QUESTION: How can this sentence be clarified by simply moving words around? (There are two possible meanings.)

20. TEXT: "The temptation for progressives to resist pushing their own concrete policy agenda is compelling, especially since **doing so** gives the other side ammunition for criticism …." (From Joel Berg, It's Policy, Stupid — Why progressives need real solutions to real problems, Washington Monthly, Apr. 10, 2017.) QUESTION: In the quotation, the bold-faced "doing so" refers to what, exactly — *pushing* a policy agenda, or *resisting* pushing an agenda? EXERCISE: Rewrite to clarify.

21. TEXT, from this tweet by the president: "'Federal Judge throws out Stormy Danials lawsuit versus Trump. Trump is entitled to full legal fees.' @FoxNews Great, now I can go after Horseface and her 3rd rate lawyer in the Great State of Texas. She will confirm the letter she signed! She knows nothing about me, a total con!" AND: This response by a liberal-leaning columnist: "While we're on the topic, can we talk about the comma in the very last sentence?"

22. TEXT, from the Sheryl Sandberg employment agreement in the Supplement, starting at page 101, lines 72-73: "[Y]our Employment will not infringe the rights of any other person." QUESTION: From a drafting-technique perspective, what's wrong with this provision?

23. TEXT, from a Paul Krugman column, NY Times, Aug. 27, 2018: "What Freedom House calls illiberalism is on the rise across Eastern Europe. This includes Poland and Hungary, both still members of the European Union, in which democracy as we normally understand it is already dead." QUESTION: *Where* is democracy supposedly already dead?

24. TEXT, from the Washington Post: "Tapper said that Conway's boss, the president, has been the subject of numerous sexual assault allegations and has said that those women lied about them." QUESTION: *Who*, exactly, said

"those women lied" — was it Tapper, or Conway's boss? How could this be clarified?

25. TEXT, from this tweet: "Man trampled to death by elephant trying to take a SELFIE". EXERCISE: Rewrite.

26. TEXT: See the strip of July 17, 2017. EXERCISE: Rewrite.

27. TEXT: "WASHINGTON (AP) – A Russian billionaire close to President Vladimir Putin said Tuesday he is willing to take part in U.S. congressional hearings to discuss his past business relationship with President Donald Trump's former campaign chairman, Paul Manafort." (AP.com) QUESTION: Who exactly is willing to take part in U.S. congressional hearings? QUESTION: How could this be clarified?

28. TEXT: See this Pearls Before Swine cartoon. (The author, Stephan Pastis, is a non-praticing lawyer.) QUESTION: How could the first panel's wording be "improved"?

29. TEXT, from a Facebook posting: "A man's success has a lot to do with the kind of woman he chooses to have in his life. (Pass this on to all great women.)" QUESTION: What's another, grossly-sexist interpretation of this quote? *(Please don't be offended by this example; we're learning here to spot — and fix — unintentional ambiguities that can be subject to intentional, motivated misinterpretation.)*

30. TEXT, In honor of Rosh Hashana (fall semester) or Passover (spring semester), from Joshua Rothman in The New Yorker: "My grandmother is ninety-three and, **to my knowledge**, has never kept kosher." QUESTION: Is there any way the bold-faced part could be misinterpreted — perhaps intentionally? QUESTION: How could this be rewritten to clarify?

31. TEXT (from a dispute that I arbitrated): A contract states that payments remaining past due more than 30 days after the due date will bear interest at "a rate per annum equal to the prime rate published by the *Wall Street Journal* on the business day before the date on which such interest begins to accrue, changing with each change in such published rate, plus two percent (2%)." FACTS: On the relevant date, the *Journal*'s published U.S. prime rate was 4.00%. QUESTION: On its face, from a drafting style perspective, what's wrong with this interest-rate provision? QUESTION: What interest rate should be applied to the late payment — 6%, or 4.08%? QUESTON: How could the interest-rate language be clarified?

32. TEXT: In November 2018, former president Barack Obama said "a challenge of working in the White House is not always getting credit 'when nothing happens. *And nothing happening is good,"* Obama said, to laughs." (From here.) QUESTION: What's another possible meaning of the italicized portion — a meaning that might also have triggered laughter? *(Hint: Think of who was occupying the Oval Office at the time.)*

33. TEXT: Adapted from my church's Easter Sunday service booklet of a few years ago (with the family's name changed): "Easter flowers and decorations are given | to the glory of God | and in memory of their grandmother Jane Doe | In honor of all Christians, | *Especially those persecuted/* | *By the Doe family.*" QUESTION: How could this be fixed with just one additional character?

34. FACTS: 1. Alice and Bob enter into a referral agreement; under that agreement, Alice must pay Bob a finder's fee for every contract that Alice "consummates" with anyone referred to her by Bob during a specified time period. 2. During the specified time period, Bob refers Carol to Alice. *Before* the specified time period ends, Alice signs a contract with Carol; BUT: Alice does not actually begin performing her obligations under the contract with Carol until *after* the specified time period ends. 3. Alice claims that she therefore does not owe Bob a finder's fee for her contract with Carol. QUESTION: What result? QUESTION: How could the finder's-fee agreement have been clarified? SOURCE: Fed Cetera, LLC v. Nat'l Credit Servs., Inc., 938 F.3d 466 (3d Cir. 2019) (reversing and remanding summary judgment in favor of "Alice").

35. TEXT, from Spanski Enterprises, Inc. v. Telewizja Polska S.A., No. 19-4066 (2d Cir. Oct. 29, 2020) (nonprecedential summary order affirming judgment below): "The term of this Agreement is 25 (twenty-five) years and it comes into effect on the date of its signing. TVP and SEI may extend its term by subsequent 10 year periods." QUESTION: May either party extend the term, or must both? QUESTION: How could this be clarified? QUESTION: Do you see any other drafting "fail"? *(In Q3, note how the question mark is outside the closing quotation mark, because the question mark isn't part of the quotation.)*

36. TEXT, from the Wikipedia page about Michigan Governor Gretchen Whitmer: "Gretchen Esther Whitmer (born August 23, 1971) is an American politician serving as the 49th governor of Michigan since 2019." QUESTION: Has Michigan *really* had 49 governors since 2019? QUESTION: How could this be rewritten to clarify?

37. TEXT, from a WaPo story about two announced Nobel laureates in economics: "The two men will receive a cash award of 10 million Swedish krona, worth a bit more than $1.1 million." QUESTION: How much will each man receive?

38. TEXT, from the Washington Post: "Rep. Sean Patrick Maloney (D-N.Y.) walked *[acting ambassador to Ukraine William]* Taylor through his U.S. Military Academy and military career, including that he was No. 5 in a class of 800 and took a tough infantry assignment in Vietnam, in an apparent effort to embarrass Republicans." QUESTION: Who, exactly, did what, "in an apparent effort to embarrass Republicans"? How could the ambiguituy be fixed?

39. TEXT, from this church sign: "Don't Let Worries | Kill You | Let The Church | Help"

# Chapter 9 General writing rules

Those new to contract drafting should learn — even memorize — the rules in this section.

> Note: This chapter "steals" from the following sources: • The U.S. Securities and Exchange Commission's Plain English Handbook (Aug. 1998) at https://goo.gl/DZaFyT (sec.gov). • The PlainLanguage.gov Web site at https://goo.gl/FcvL (PlainLanguage.gov), by "a group of federal employees from many different agencies and specialties who support the use of clear communication in government writing." • The U.S. Air Force's writing guide, The Tongue and Quill (rev. Nov. 2015), at https://goo.gl/1y1b0j (static.e-publishing.af.mil). This "theft" is legal because under 17 U.S.C. § 105, copyright is not available for works that were created by officers or employees of the U.S. Government in the course of their official duties; see generally the Wikipedia article Copyright status of work by the U.S. government.

## 9.1 Style guide for numbers

This section sets out some stylistic conventions that are commonly followed in drafting contracts.

> As with all stylistic conventions: • If your supervisor prefers one way over another, then do it that way (see § 6.1). • *Don't* make purely-stylistic revisions in another party's draft contract (see § 6.2).

1. Spell out the numbers one through ten; use numerals for 11, 12, 13, etc.

> Some style guides say to spell out numbers one through *nine*. See also When Should I Spell Out Numbers? (Grammerly.com)

2. Both in the same sentence? Consider using just numbers: *The quiz will contain between 8 and 12 questions*.

3. Don't start a sentence with numerals; either spell out the numerals in words or (preferably) rewrite the sentence.

| BEFORE | AFTER |
|---|---|
| 42 was Douglas Adams's answer to The Ultimate Question of Life, the Universe, and Everything. | According to the late novelist Douglas Adams, the answer to The |

> Ultimate Question of Life, the Universe, and Everything is … 42.

4. Spell out million, billion, trillion — but *not* thousand. *Example:* More than ~~300,000,000~~ 300 million people live in the United States. *Example:* Alice will pay Bob ~~$5 thousand~~ $5,000.

5. **Important:** Don't spell out a number in words and then restate the number in numerals. *Example:* More than ~~three hundred~~ 300 million ~~(300,000,000)~~ people live in the United States.

> Why this rule? Because there's too much danger of changing one but inadvertently neglecting to change the other. (See § 8.8, "D.R.Y. — "Don't Repeat Yourself" for how this can be a very *expensive* mistake, costing a Dallas-area lender $693,000.)

6. Don't say "in United States dollars" if there's no possibility of confusion.

> If you feel the need to be clear that dollars refers to U.S. dollars, you can do that in your definitions & usages section (see § 4).

7. If currency confusion *is* a possibility, then use ISO 4217 currency abbreviations such as USD, as in: *Buyer will pay USD $30 million*. (The USD abbreviation goes where indicated, *not* after the numbers.)

8. Don't spell out dollar amounts in words. *Example:* Alice will pay Bob ~~five thousand dollars~~ $5,000.

9. Omit zero cents unless relevant. *Example:* Alice will pay Bob ~~$5,000.00~~ $5,000. *But:* Alice will pay Bob $3,141.59.

10. Spell out a percentage if it's at the beginning of a sentence — or just use numbers and rewrite the sentence to avoid starting with the percentage. *Example:* ~~30%~~ Thirty percent of the proceeds will be donated to charity. *Better:* Of the proceeds, 30% will be donated to charity.

11. Time is written with digits: 5:00 p.m. not five p.m.

## 9.2 Parallelism in lists: Be consistent

In lists, you should be able to delete any item in the list and still have the sentence make sense grammatically. *Example:* The police officer told us *to observe* the speed limit and ~~we should dim~~ *to dim* our lights.

## 9.3 Avoid gobbledygook

From the PlainLanguage.gov Website:

| BEFORE | AFTER |
|---|---|
| Consultation from respondents was obtained to determine the estimated burden. | We consulted with respondents to estimate the burden. |

## 9.4 Active voice is better — usually

Active voice gets to the point by putting the actor first. Look at the following before-and-after examples:

| BEFORE | AFTER |
|---|---|
| A song was sung by her. | She sang a song. |

But **sometimes passive voice is better**, for example if the doer or actor of the action is unknown, unimportant, obvious, or better left unnamed:

- The part is to be shipped on 1 June. (If the actor is unclear or unimportant.)
- Presidents are elected every four years. (The actors are obvious.)
- Christmas has been scheduled as a workday. (The actor is better left unsaid.)

And clear, forceful, active-voice language might be inappropriate in diplomacy; in political negotiations — or in contract negotiations.

> The original USAF sentence said "… may be inappropriate," but it's better to stick with "might be" — use "may" for permission, "might" for possibility (see § 9.7).

## 9.5 Streamline your sentences

It's too easy to let a sentence get fat and sloppy. Here are a few examples:

| BEFORE | AFTER |
|---|---|
| They made the decision to give their approval. | They decided to approve it.<br>*Or:* They approved it. |
| The team held a meeting to give | The team met to consider the |

| | |
|---|---|
| consideration to the issue. | issue.<br>*Or:* The team considered the issue. |
| We will make a distribution of shares. | We will distribute shares. |
| We will provide appropriate information to shareholders. | We will inform shareholders. |
| We will have no stock ownership of the company. | We will not own the company's stock. |
| There is the possibility of prior Board approval of these investments. | The Board might approve these investments in advance. |
| The settlement of travel claims involves the examination of orders. | Settling travel claims involves examining orders. |
| Use 1.5 line spacing for the preparation of your contract draft. | Use 1.5 line spacing to prepare your contract draft.<br><br>*Better:* Use 1.5 line spacing for your draft contract. |

## 9.6 Word order might matter

Example: "We want **only** the best" has a slightly-different meaning than "We **only** want the best."

Another example, excerpted from StackExchange:

> I eat fish **only** when I'm sick.
>
> I eat **only** fish when I'm sick.

And another example, also excerpted from StackExchange:

> (2) In 1996, **only** Ford sold a rebadged Mazda 626 GV over here as its re-branded Japanese mid-size stationwagon. *(Ford was the only manufacturer)*
>
> * * *
>
> (4) In 1996, Ford sold a rebadged Mazda 626 GV over here as its **only** re-branded Japanese mid-size stationwagon *(there were no others, I assume?)*

## 9.7 "May" and "might" are different

To avoid possible confusion:

- Use *may* to indicate *permission*: *ABC may delay payment until December 31*.
- Use *might* to indicate *possibility*: *It might rain tomorrow*.

This can be summarized in the acronym *MPMP*: May for Permission, Might for Possibility.

## 9.8 Exercises and discussion questions

1. Which is it: "Class starts at X o'clock": A) ten B) 10:00
2. Which is it: "More than X people voted to re-elect President Trump": A) 74,000,000 B) seventy-four million C) 74 million.
3. Which is used to indicate *permission*: May, or might?
4. Which is used to indicate *possibility*: May, or might?

# Chapter 10 Interlude: Microsoft Word

## 10.1 Microsoft Word key features

*[Students: Items 1-5 are fair game for testing; the remaining items are nice to know but won't be tested.]*

1. The safest way to format a paragraph without corrupting the document and crashing the Word program is to format the style of the paragraph, not the individual paragraph itself.

> See, e.g., The Styles advantage in Word (https://goo.gl/v8Jbej); Item 3 in the 2013 list of tips to avoid crashing Word, by John McGhie (https://goo.gl/VxqJKs). NOTE: McGhie's tip no. 2 is to avoid Track Changes, but I've never had a problem with it — at least so far as I know ….

2. To create a heading, use Heading styles: Heading 1, Heading 2, etc.

3. Headings can be automatically numbered by using the Bullets and Numbering feature under Format. The following apply mainly to the formatting of

*styles*, but can be used with caution to format individual paragraphs:

4. On rare occasions, to adjust the line spacing within a specific paragraph, use the menu sequence: Format | Paragraph | Indents and Spacing | Spacing (almost smack in the middle of the dialog box on a Mac).

5. To adjust the spacing between paragraphs, use the menu sequence: Format | Paragraph | Indents and Spacing menu. *Don't* use a blank line to separate paragraphs — adjust the spacing instead.

> See generally Practical Typography: Spacing Between Paragraphs (PracticalTypography.com: https://goo.gl/vNjeKF).

6. To keep one paragraph on the same page with the following paragraph (which is sometimes useful), use the menu sequence Format | Paragraph | Line and Page Breaks | Keep with Next.

Here are some other tips:

7. A table of contents can be useful in a long contract. To create a table of contents, in the References tab, use the Table of Contents dropdown box and select Custom Table of Contents.

8. Tables can sometimes be useful in contracts. To remove the borders from a table (the way Word normally creates them), first use the menu sequence: Table | Select | Table. Then use the menu sequence: Format | Borders & Shading | Borders | None.

9. To copy and paste a short snippet from a Web page into a Microsoft Word document without messing up the formatting of the paragraph into which you're pasting the snippet, use the menu sequence: Edit | Paste Special | Unformatted text. (Alternatively: Edit | Paste and Match Formatting.)

## 10.2 Exercises and discussion questions

1. Explain if false: One valid way to add space between two paragraphs in Microsoft Word is to just put an extra blank line between the paragraphs.

# Chapter 11 Drafting tips

Contents:

## 11.1 False imperatives: *Who* is responsible?

Passive voice is often disfavored in contracts (and elsewhere). But passive voice isn't necessarily a serious error — *unless the passive-voice provision leaves it unclear who must do what*. This is sometimes referred to as a "false imperative."

Think of a false imperative two baseball outfielders who let an easily-catchable fly ball drop to the ground between them because neither one "calls it" and each assumes that the other will get it.

*Example:* A limited-partnership agreement provided that a partner was to be paid money, but the agreement used the passive-voice "shall be paid." This led to litigation over just who was supposed to make the payment — was it the limited partnership, or the general partner? An appeals court summarized the situation:

"In section 6.2, the Partners used the passive voice in the critical sentence. They stated "shall be paid or distributed" without identifying which entity or entities must pay or distribute the Partnership Capital Event Receipts."

> ASR 2620-2630 Fountainview, LP v. ASR 2620-2630 Fountainview GP, LLC, 582 S.W.3d 556, 561 (Tex. App.–Houston [14th Dist.] 2019, no pet.) (affirming, in relevant part, judgment on jury verdict).

*Hypothetical example:* Suppose that:

- A real-estate developer enters into a construction agreement with a general contractor;
- Under the construction agreement, the contractor is to build a building;
- Because of the nature of the building site, special safety procedures will be needed for all personnel coming on the site;
- The construction agreement says simply: "*All Developer personnel are to be trained in special safety procedures for the Building Site*."

This is another example of a so-called "false imperative," because it arguably leaves unclear just *who* is responsible for training the developer's personnel in the special safety procedures.

(Other portions of the construction agreement might shed light on the question, but that's not the ideal situation.)

A useful business expression (albeit a bit trite from overuse) is *One Throat to Choke!*

> See, e.g., Wiktionary.

**Drafting lesson:** Even when passive voice is appropriate, a contract provision should not leave any room for doubt about *who* is responsible for making Item X happen, or preventing Event Y from happening).

## 11.2 Roadblock clauses

It can be useful for a contract to explicitly rule out an argument that the other side might someday make. For example, the Texas supreme court rendered a take-nothing judgment, reversing a $100M jury verdict for punitive damages against Mercedes-Benz USA, because the plaintiff's fraudulent-inducement claim was conclusively negated by the contract's express terms. The supreme court summed up its holding and rationale:

> The issue here is whether Carduco's belief that Mercedes had promised the McAllen [sales] area to it was justified in light of the parties' written agreement. Because that agreement[:]
>
> - approved and identified only Harlingen as Carduco's dealership location,
> - *provided that Carduco could not move, relocate, or change any dealership facilities without Mercedes's prior written consent*,
> - provided that Carduco's right to sell cars in any specific geographic area was nonexclusive, and
> - *stated that the agreement was not intended to limit Mercedes's right to add new dealers in the area*,
>
> we conclude that the parties' written agreement directly contradicts Carduco's alleged belief and thereby negates its justifiable reliance as a matter of law. The court of appeals' judgment affirming the award of actual and punitive damages is accordingly reversed and judgment rendered that Carduco take nothing.

> Mercedes-Benz USA, LLC v. Carduco, Inc., 583 S.W.3d 553, 554-55 (Tex. 2018) (emphasis, bullets, and extra paragraphing added).

## 11.3 Sunset provisions

It's usually worth considering whether a particular right — or obligation — should have an explicit "sunset" date, i.e., a date certain (or a date-determinable) when the right or obligation comes to an end.

*Example:* Suppose that ABC Corp. is negotiating a confidentiality agreement under which ABC will be receiving confidential information of XYZ Inc. for a stated purpose. ABC might want its confidentiality obligations to come to an end automatically in X number of years, so that it won't have to think about and manage those obligations after that time.

## 11.4 Conspicuousness: Go easy on the all-caps

### 11.4.1 Overview

In some jurisdictions, certain types of clauses might not be enforceable unless they are "conspicuous." For clauses in this category, courts typically want extra assurance that the signers knowingly and voluntarily assented to the relevant terms and conditions.

*Example:* Under the "express negligence" doctrine in Texas law, an indemnity provision that purports to protect a party from the consequences of its own negligence must not only be expressly stated, it must also be "conspicuous" in accordance with the Uniform Commercial Code standard.

> See Dresser Indus., Inc. v. Page Petroleum, Inc., 853 S.W.2d 505, 508-09 (Tex. 1993) (adopting UCC's standard of conspicuousness for express-negligence indemnification doctrine).

### 11.4.2 All-caps ≠ "conspicuous" – and might be dangerous?

Contract drafters sometimes put entire paragraphs into all-capital letters in the hope of making them "conspicuous." The reader has probably seen examples of this particular disorder in warranty disclaimers and limitations of liability.

But keeping the all-caps going for line, after line, after line, can be self-defeating. A Georgia supreme court justice noted that the drafter of a contract in suit had made the justice's job more difficult — which is not a good look, to put it mildly:

> No one should make the mistake of thinking, however, that capitalization always and necessarily renders the capitalized language conspicuous and prominent.
>
> In this case, *the entirety of the fine print appears in capital letters*, all in a relatively small font, rendering it difficult for the author of this opinion,

> among others, to read it.
>
> Moreover, *the capitalized disclaimers are mixed with a hodgepodge* of other seemingly unrelated, boilerplate contractual provisions — provisions about, for instance, a daily storage fee and a restocking charge for returned vehicles — *all of which are capitalized* and in the same small font.
>
> Raysoni v. Payless Auto Deals, LLC, 296 Ga. 156, 766 S.E.2d 24, 27 n.5 (2014) (reversing and remanding judgment on the pleadings) (emphasis and extra paragraphing added).

In a similar vein, the Ninth Circuit's Judge Alex Kozinski noted acerbically:

> Lawyers who think their caps lock keys are instant"'make conspicuous" buttons are deluded. … A sentence in capitals, buried deep within a long paragraph in capitals will probably not be deemed conspicuous.
>
> Formatting does matter, but conspicuousness ultimately turns on the likelihood that a reasonable person would actually see a term in an agreement.
>
> In re Bassett, 285 F.3d 882, 886 (9th Cir. 2002) (cleaned up, emphasis and extra paragraphing added).

Even worse, drafting a long block of text in all-caps might actually hurt the drafter's own client. Here's a tweet by Boston-area tech lawyer turned entrepreneur Luis Villa: "Love to see an ALL CAPS AND BOLD section of a contract that is so typographically painful to read that *the company's lawyers didn't actually proof it, and made a substantive error in my favor* as a result." (Emphasis added.)

The drafting tips here, of course, are:

a. Be judicious about what you put in all-caps.

b. Don't use too-small a font for language that you want to be conspicuous.

If you want an example of what NOT to do to make something conspicuous, just glance at (don't even *try* to read) the following abomination, which is near the very front of a real-estate purchase agreement for a Dallas-area "gentlemen's club":

> **Section 1.02. Disclaimer and Indemnity.** THE PROPERTY SHALL BE CONVEYED AND TRANSFERRED TO PURCHASER "AS IS, WHERE IS AND WITH ALL FAULTS". EXCEPT FOR THE REPRESENTATIONS, WARRANTIES AND COVENANTS OF SELLER SET FORTH IN ARTICLE V OF THIS AGREEMENT, SELLER DOES NOT WARRANT OR MAKE ANY REPRESENTATIONS, EXPRESS OR IMPLIED, AS TO FITNESS FOR A PARTICULAR PURPOSE, MERCHANTABILITY, DESIGN, QUANTITY, QUALITY, LAYOUT, FOOTAGE, PHYSICAL CONDITION, PERATION, COMPLIANCE WITH SPECIFICATIONS, ABSENCE OR LATENT DEFECTS OR COMPLIANCE WITH LAWS AND REGULATIONS (INCLUDING, WITHOUT LIMITATION, THOSE RELATING TO HEALTH, SAFETY AND THE ENVIRONMENT) OR ANY OTHER MATTER AF-

> FECTING THE PROPERTY AND SELLER SHALL BE UNDER NO OBLIGATION WHATSOEVER TO UNDERTAKE ANY REPAIRS, ALTERATIONS OR OTHER WORK OF ANY KIND WITH RESPECT TO ANY PORTION OF THE PROPERTY. FURTHER, PURCHASER SHALL INDEMNIFY, DEFEND AND HOLD HARMLESS SELLER AND SELLER'S REPRESENTATIVES FROM AND AGAINST ANY CLAIMS OR CAUSES OF ACTION ARISING OUT OF THE CONDITION OF THE PROPERTY BROUGHT BY ANY OF PURCHASER'S SUCCESSORS OR ASSIGNS, OR ANY THIRD PARTY, AGAINST SELLER OR SELLER'S REPRESENTATIVES. INFORMATION PROVIDED OR TO BE PROVIDED BY SELLER IN RESPECT OF THE PROPERTY WAS OBTAINED FROM A VARIETY OF SOURCES. SELLER HAS NOT MADE AN INDEPENDENT INVESTIGATION OF SUCH INFORMATION AND MAKES NO REPRESENTATIONS AS TO THE ASSURACY OR COMPLETENESS THEREOF. PURCHASER HEREBY ASSUMES ALL RISK AND LIABILITY RESULTING FROM THE OWNERSHIP, USE, CONDITION, LOCATION, MAINTENANCE, REPAIR OR OPERATION OF THE PROPERTY, WHICH PURCHASER WILL INSPECT AND ACCEPT "AS IS". IN THIS REGARD, PURCHASER ACKNOWLEDGES THAT (a) PURCHASER HAS NOT ENTERED INTO THIS AGREEMENT IN RELIANCE UPON ANY INFORMATION GIVEN TO PURCHAWSER PRIOR TO THE DATE OF THIS AGREEMENT, INCLUDING, BUT NOT LIMITED TO, PROMOTIONAL MATERIALS OR FINANCIAL DATA , (b) PURCHASER WILL MAKE ITS DECISION TO PURCHASE THE PROPERTY BASED UPON PURCHASER'S OWN DUE DILIGENCE AND INVESTIGATIONS, (c) PURCHASER HAS SUCH KNOWLEDGE AND EXPERIENCE IN REAL ESTATE INVESTIGATION TO EVALUATE THE MERITS AND RISKS OF THE TRANSACTIONS PROVIDED IN THIS AGREEMENT, AND (d) PURCHASER IS FINANCIALLY ABLE TO BEAR THE ECONOMIC RISK OF THE LOSS OF SUCH INVESTMENT AND THE COST OF THE DUE DILIGENCE AND INVESTIGATIONS UNDER THIS AGREEMENT. IT IS UNDERSTOOD AND AGREED THAT THE PURCHASE PRICE HAS BEEN ADJUSTED BY PRIOR NEGOTIATION TO REFLECT THAT THE PROPERTY IS SOLD BY SELLER AND PURCHASED BY PURCHASER SUBJECT TO THE FOREGOING. Disclaimers similar to the foregoing in form satisfactory to Seller as well as Seller's reservation of the mineral estate shall be inserted in any and all documents to be delivered by Seller to Purchaser at Closing.

This example is from https://www.sec.gov/Archives/edgar/data/935419/000114036108012368/ex10_2.htm. If you're wondering who's responsible for this piece of [work], the names and addresses of the parties' counsel are included in the addresses for notice in section 10.03.

### 11.4.3 The UCC definition of conspicuousness

The [U.S.] Uniform Commercial Code doesn't apply to all types of transaction, nor in jurisdictions where it has not been enacted.

Still, the UCC's definition of "conspicuous," such as in section UCC § 1-201(10) (Texas version) nevertheless provides useful guidance:

> "Conspicuous," with reference to a term, means so written, displayed, or presented that *a reasonable person against which it is to operate ought to have noticed it*.
>
> Whether a term is "conspicuous" or not is a decision for the court.
>
> Conspicuous terms include the following:
>
> (A) a heading in capitals equal to or greater in size than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same or lesser size; and
>
> (B) language in the body of a record or display in larger type than the surrounding text,
>
> or in contrasting type, font, or color to the surrounding text of the same size,
>
> or set off from surrounding text of the same size by symbols or other marks that call attention to the language.

Tex. Bus. & Com. Code § 1.201(10) (emphasis and extra paragraphing added).

Courts often adopt the UCC standard for conspicuousness, as explained in the next section.

### 11.4.4 Courts tend to focus on "fair notice"

In a non-UCC context, the Supreme Court of Texas held that — with a possibly-significant exception — an indemnity provision protecting the indemnitee from its own negligence must be sufficiently conspicuous to provide "fair notice." The supreme court adopted the conspicuousness test stated in the UCC, quoted above; the court explained:

> This standard for conspicuousness in *[Uniform Commercial]* Code cases is familiar to the courts of this state and conforms to our objectives of commercial certainty and uniformity. We thus adopt the standard for conspicuousness contained in the Code for indemnity agreements and releases like those in this case that relieve a party in advance of responsibility for its own negligence.
>
> *When a reasonable person against whom a clause is to operate ought to have noticed it, the clause is conspicuous.*
>
> For example, language in capital headings, language in contrasting type or color, *and language in an extremely short document*, such as a telegram, is conspicuous.

Dresser Indus., Inc. v. Page Petroleum, Inc., 853 S.W.2d 505, 508-09 (Tex. 1993) (citations omitted, emphasis and extra paragraphing added).

The court also pointed out that the fair-notice requirement did *not* apply to settlement releases: "Today's opinion applies the fair notice requirements to in-

demnity agreements and releases only when such exculpatory agreements are utilized to relieve a party of liability for its own negligence *in advance*."

> *Id.*, 853 S.W.2d at 508 n.1 (emphasis added).

### 11.4.5 Fair notice will often depend on the circumstances

What counts as "conspicuous" will sometimes depend on the circumstances. In still another express-negligence case, the Texas supreme court said that the indemnity provision in question did indeed provide fair notice because:

> The entire contract between Enserch and Christie consists of one page; the indemnity language is on the front side of the contract and is not hidden under a separate heading.
>
> The exculpatory language and the indemnity language, although contained in separate sentences, appear together in the same paragraph and the indemnity language is not surrounded by completely unrelated terms.
>
> Consequently, the indemnity language is sufficiently conspicuous to afford "fair notice" of its existence.

> Enserch Corp. v. Parker, 794 S.W.2d 2, 8-9 (Tex. 1990) (extra paragraphing added).

### 11.4.6 Proven actual knowledge might be enough

Texas's *Dresser* court noted an exception to the conspicuousness requirement: "The fair notice requirements are not applicable when *the indemnitee establishes* that the indemnitor possessed actual notice or knowledge of the indemnity agreement."

> Dresser, 853 S.W.2d at 508 n.2 (emphasis added, citation omitted).

Note especially the italicized portion of the quotation, which implies that the burden of proof of actual notice or knowledge is on the party claiming indemnification from its own negligence.

In contrast, a federal district judge in Houston granted Enron's motion to dismiss Hewitt Associates' claim for indemnity, on grounds that the contract in question did not comply with the conspicuousness requirement of the "express negligence" rule, namely that an agreement to indemnify a party for the consequences of *the party's own negligence* must be both *express* and *conspicuous*).The judge surveyed prior cases in which actual knowledge (of an indemnity clause) had been sufficiently established, including by ways such as:

- evidence of specific negotiation, such as prior drafts;
- through prior dealings of the parties, for example, evidence of similar contracts over a number of years with a similar provision;

- proof that the provision had been brought to the affected party's attention, e.g., by a prior claim.

> See Enron Corp. Sav. Plan v. Hewitt Associates, LLC, 611 F.Supp.2d 654, 673-75 (S.D. Tex. 2008).

## 11.5 Safe-harbor clauses

The term "safe harbor" is used to denote one, non-exclusive way of definitively complying with a requirement. The term is used in, for example, tax law and securities law. See generally, e.g.:

- 15 U.S.C. § 77z-2 and § 78u-5 (safe harbors for forward-looking statements)
- Stephen Fishman, Landlords Must Be In Business to Claim the 20% Pass-Through Tax Deduction (Nolo.com)
- Safe harbor (Investopedia.com)

## 11.6 Boomerang clauses could hurt *you* later

In the Kingston Trio's (somewhat-offensive) 1958 version of the risqué Spanish-language song *Coplas*, Dave Guard's "translation" of one verse is, *Tell your parents not to muddy the water around us — they may have to drink it soon.* Contract drafters will often do well to heed similar advice: Their clients might someday have to live with the hardball provision they force the other side to accept. This section discusses a few examples.

### 11.6.1 Example: Trump Corporation's lease terms

*(Author's note: This section was written before Donald Trump announced his successful 2016 presidential campaign.)*

Trump Corporation ("Trump") has been a real-estate landlord, among other things. According to AmLaw Daily, years ago Trump's lawyers took one of the company's leases, changed the names, and used it for a deal in which Trump was the *tenant* and not the landlord.

Later, Trump-as-tenant found that its lease-agreement form gave Trump's *landlord* significant leverage:

> "The funny part of it is what one of his internal lawyers must have done years ago," [the landlord's president] says. "Normally Trump is the landlord, not the tenant. So what they did is they took one of their leases and

> just changed the names. And so it's not a very favorable lease if you're the tenant."
>
> See Nate Raymond, *Trump Misses Rent Payments …,* http://goo.gl/B72TIr (AmLawDaily.Typepad.com) (accessed Apr. 27, 2015).

Ouch ….

### 11.6.2 Example: Tilly's sets the signature bar too high

Tilly's, Inc. and World of Jeans & Tops, Inc. ("Tilly's") had an employee sign an employment agreement (the "2001 employment agreement") containing an arbitration provision. The 2001 employment agreement included a carve-out for statutory claims (which thus could be brought in court, not in arbitration). *Importantly*, the 2001 employment agreement also stated that any modifications to the agreement would need the signatures of three executives: The company's president; senior vice president; and director of human resources.

In 2005, the company had its employees sign an acknowledgement of receipt of an employee handbook containing a different arbitration provision, which didn't contain the carve-out for statutory claims. BUT: The signed acknowledgement *didn't contain the three executive signatures* needed to modify the 2001 employment agreement.

So: Because Tilly's set the so bar high for modifying the 2001 employment agreement — requiring *three* executive signatures — the company found itself facing high-stakes litigation by *a class* of plaintiffs, whereas it had *thought* it would be arbitrating low-stakes claims individually.

> See Rebolledo v. Tilly's, Inc., 228 Cal. App. 4th 900, 924, 175 Cal. Rptr. 3d 612 (Cal. App. 4th Div. 2014) (affirming denial of motion to compel arbitration).

### 11.6.3 Example: A *one-way* NDA later leaves a party unprotected

With a *one-way* nondisclosure agreement, only the originally-intended disclosing party's information is protected. This means that any disclosures *by the receiving party* might be completely unprotected — resulting in the receiving party's losing its trade-secret rights in its information.

That's just what happened to the plaintiff in a Seventh Circuit case: The plaintiff signed a confidentiality agreement with the defendant, but that agreement protected only the *defendant's* information. Consequently, the plaintiff's later disclosures of its *own* confidential information were unprotected.

> See Fail-Safe, LLC v. A.O. Smith Corp. 674 F.3d 889, 893-94 (7th Cir. 2012) (affirming summary judgment for defendant).

(It's not hard to imagine the thought process that the plaintiff's business people's went through: "We need to disclose *our* information to *you*, but hey,

we've already got an NDA in place, so sure, let's do it." But the NDA didn't do what the plaintiff needed.)

## 11.7 Jerks: Drafting for them

It's inevitable: Sooner or later, every contract drafter (and reviewer) will come up against a counterpart for The Other Side who is implacable and maybe even just plain unreasonable. This section offers some suggestions for dealing with such folks. There's no guarantee that any of these suggestions will work in a given case, but they might help.

### 11.7.1 Don't kick a sleeping dog

The scene:

- You're in a contract negotiation, representing The Good Guys Company.
- The other side, Nasty Business Partner Inc., insists on requiring The Good Guys to get NBP's consent before assigning the agreement.
- Nasty Business Partner has all the bargaining power; the Good Guys decide they have no choice but to go along.

Trying to salvage the situation, you ask Nasty Business Partner for some additional language: "Consent to assignment may not be unreasonably withheld, delayed, or conditioned." But Nasty Business Partner refuses. **Have you just screwed your client?**

In some jurisdictions, *The Good Guys might otherwise have benefited from a default rule* that Nasty Business Partner Inc. had an *implied* obligation not to unreasonably withhold consent to an assignment of the contract.

> See, e.g., Shoney's LLC v. MAC East, LLC, 27 So.3d 1216, 1220-21 (Ala. 2009); Pacific First Bank v. New Morgan Park Corp., 876 P.2d 761 (Or. 1994).

But you *asked* for an express obligation — only to have Nasty Business Partner reject the request — and The Good Guys signed the contract anyway.

A court might therefore conclude that the parties had agreed that Nasty Business Partner would not be under an obligation not to unreasonably withhold its consent to assignment — that NBP could grant or withhold its consent in its sole discretion.

This is pretty much what happened, on somewhat-different facts, in both the *Shoney's LLC* and *Pacific First Bank* cases cited above.

**The Team Coco example:** You might remember that TV talk-show host Conan O'Brien's stewardship of *The Tonight Show* proved disappointing to NBC. The network decided to move Jay Leno back into that time slot and bump Co-

nan back to 12:05 a.m. This led Conan to want to leave the show and start over on another network — but if he had, he would arguably have been in breach of his contract with NBC.

Conan's contract apparently did not state that *The Tonight Show* would always start at 11:35 p.m. Conan's lawyers were roundly criticized for that alleged mistake by ex-Wall Streeter Henry Blodget and some of his readers.

> See Conan's Lawyers Screwed Up, Forgot To Specify "Tonight Show" Time Slot (BusinessInsider.com Jan. 11, 2010), especially the reader comments following the article.

But then wiser heads pointed out that Conan's lawyers might have intentionally not asked for a locked-in start time:

- The Tonight Show had started at 11:35 p.m. for decades; Conan's lawyers could have plausibly argued that this start time was part of the essence of The Tonight Show, and thus was an implied part of the contract.
- Suppose that Conan's lawyers had asked for the contract to *lock in* the 11:35 p.m. start time of The Tonight Show, but that NBC had refused. A court might then have interpreted the contract as providing that NBC had at least some freedom to move the show's start time.
- Indeed, NBC might have responded by insisting on just the opposite, namely a clause affirmatively stating that NBC was free to choose the start time.
    - Given that NBC had more bargaining power than Conan at that point, Conan might then have had no choice but to agree, given that he wanted NBC to appoint him as the host of the show.
    - And in that case, there'd be no question that NBC had the right to push the start time of the show back to 12:05 p.m.

Ultimately, Conan and NBC settled their dispute; the network bought out Conan's contract for a reported $32.5 million. This seems to suggest that NBC was concerned it might indeed be breaching the contract if it were to push back The Tonight Show to 12:05 a.m. as it wanted to do. As an article in *The American Lawyer* commented:

> … If O'Brien had asked that the 11:35 p.m. time slot be spelled out in any agreement—and had NBC refused—the red pompadoured captain of "Team Coco" would be in a weaker position in the current negotiations.
>
> "If you ask and are refused, or even worse, if you ask and the other side pushes for a 180, such as a time slot not being guaranteed, you can end up with something worse," [attorney Jonathan] Handel adds.
>
> Without having their hands bound by language in the contract on when "The Tonight Show" would air, O'Brien's lawyers are in a better position to negotiate their client's departure from NBC.

> Brian Baxter, Legal Angles Abound as Conan-NBC Standoff Nears Endgame (AmLaw Daily Jan. 19, 2010) (extra paragraphing added).

Judging by the outcome, it may well be that Conan's lawyers did an A-plus job of playing a comparatively-weak hand during the original contract negotiations with NBC.

The lesson: Be careful what you ask for in a contract negotiation — if the other side rejects your request but you do the deal anyway, that sequence of events might come back to haunt you later.

### 11.7.2 Hamburger for the guard dog

When drafting a contract, it can pay to include a clause that you know the other side will insist on getting, even if you'd really prefer to omit the clause.

EXAMPLE: Suppose that you're drafting a contract under which your client is obligated to pay the other side a percentage of its (your client's) sales. The contract might be an intellectual-property license agreement, or perhaps a real-estate lease.

*It might be tempting to omit an audit clause from your draft*. Your reasoning could be that the other side's contract reviewers might not think to ask for such a clause, and it's not your job to remind them.

**But** consider these points:

• In imagining that the other side's reviewer won't notice the absence of an audit clause omission, you might be indulging in wishful thinking — the other side's reviewer might be an expert who knows exactly what to look for and what to demand.

• If the other side's contract reviewer were to see an audit clause in your draft, he or she might well mentally check the box — *yup, they've got an audit clause* — and move on to other matters, without making significant changes to your wording. That's a win, not least because it's one less thing to negotiate.

• You might be better off setting the tone with an audit clause *that you know your client can live with*, and then standing on principle to reject unreasonable change requests.

• Suppose the other side doesn't really know what they're doing. Chances are you'll get the other side to signature faster — and you'll be laying a foundation for a trusting relationship — if the draft you're proposing seems to address the other side's needs as well as your client's needs.

### 11.7.3 The reality: Personal incentives matter

Berkshire Hathaway's vice-chairman Charles Munger has said that "Never a year passes but I get some surprise that pushes a little further my appreciation

of incentive superpower. * * * Never, ever, think about something else when you should be thinking about the power of incentives."

> Charles T. Munger, The Psychology of Human Misjudgment (fs.blog), archived at https://perma.cc/LNG7-JG6Y.

When drafting a contract, it can pay dividends to give some thought to how to manage the so-called "agency costs" that can arise from these personal interests and incentives of individual players. That's because when disputes arise, the involved individuals will naturally want to protect their own interests, such as: • not having fingers pointed at them; • being thought of by their side as a committed team player who's willing to fight to win, not a defeatist who throws in the towel; • protecting their bonus, their commission, their pay raise, their promotion, etc.

> See generally Agency cost (Wikipedia.org); a somewhat more-readable presentation is at Agency Costs (Investopedia.com).

These desires can manifest themselves in a variety of ways; some of the Tango Terms can help to channel these incentives and manage individuals' expectations.

### 11.7.4 What if you can't just say "no"?

Your client might not have the bargaining power to get its way in contract negotiations. When that's the case, you have to try to come up with other ways to help protect the client's legal- and business interests.

Imagine, for example, that your client is a customer that is negotiating a master purchasing contract with a vendor.

- Your customer client would love to flatly prohibit the vendor from raising prices without the customer's consent. But the vendor's negotiators won't go along with such a prohibition.
- The vendor would love to have the unfettered discretion to raise your customer client's prices whenever the vendor wants. But your client's business people are insisting on having at least some protection on that score.

What to do? In no particular order, here are some approaches that you could try.

**Non-discrimination language?** A non-discrimination requirement at least brings a bit of overall-market discipline into the picture.

*Example:* "Vendor will not increase the prices it charges to Customer except as part of a non-targeted, across-the-board pricing increase by Vendor, applicable to its customers generally, for the relevant goods or services."

*Comment:* Vendor might want to qualify this language, so as to limit how general a price increase must be before it can be applied to Customer.

**Advance warning or -consultation?** An advance-warning or advance-consultation requirement can buy time for its beneficiary to look around for alternatives (assuming of course that the contract doesn't lock in the beneficiary somehow, for example with a minimum-purchase requirement or a "requirements" provision).

*Example:* Vendor will give Customer at least X [days | months] advance notice of any increase in the pricing it charges to Customer under this Agreement.

**Transparency requirement?** Requiring a party to provide information justifying its action, upon request, can force that party to think twice about doing something, even though it technically has the right to do it.

*Example:* If requested by Customer within X days after notice of a pricing increase, Vendor will seasonably provide Customer with documentation showing, with reasonable completeness and accuracy, a written explanation of the reason for the increase, including reasonable details about Vendor's relevant cost structures relevant to the pricing increase. Customer will maintain all such documentation in confidence any non-public information in such explanation, will not disclose the non-public information to third parties, and will use it only for purposes of making decisions about potential purchases under this Agreement.

*Comment:* Note the *if-requested* language, which relieves the vendor from the burden of continually managing this requirement — although a smart vendor would plan ahead and have the required documentation ready to go.

**Draw the thorn from the lion's paw?** When a party makes tough contract demands, it could be because the party has been burned before. Institutionally, it may still "feel the pain" of a bad experience; its response is to roar at other counterparties.

The counterparty being roared at can try to find out why the lion is roaring. If it can identify the source of the pain, it might be able to figure out another way to make it better, without undertaking burdensome obligations.

The allusion here, of course, is to the ancient folk tale about Androcles and the lion.

**Cap the financial exposure for the onerous provision?** A party with bargaining power will often demand that its counterparty agree to an onerous provision. In response, the counterparty could ask the first party to agree to a dollar cap on the amount of the counterparty's resulting financial exposure, e.g., capping the amount of money that the counterparty would be required to spend or the liability that it might someday face.

If the first party agrees, the onerous provision might look less dangerous to the counterparty than it would with the prospect of unlimited expense and/or liability.

(This is a variation on the old saying: *When in doubt, make it about money*.)

**Impose time limits?** When a party asks its counterparty to agree to an onerous contract provision, the counterparty might try to make its business risk more manageable by imposing time limits on the onerous provision.

For example, if a party demands an oppressive indemnity, the counterparty might counter by asking for a time limit on claims covered by the indemnity.

Or if a party demands a cap on pricing increases, or a most-favored-customer clause, the counterparty could counter with time limits on those as well.

**Explain why the provision hurts the demanding party?** A counterparty can to try to explain to a demanding party why, in the long run, the onerous provision being demanded would ultimately cause problems for the demanding party.

**Package as part of a premium offering?** Suppose that a smallish supplier is regularly asked by its customers to agree to an onerous contract provision (e.g., an extended warranty). If the supplier plans ahead, it can package the onerous provision as part of a *higher-priced* premium offering — with the relevant contract language being written in a way the supplier knows it can support.

This approach has a huge advantage: The bargaining over whether to give a customer the premium offering is no longer about legal T&Cs: it becomes a negotiation about **price**. This means the supplier's legal people might not even have to get involved — which often can be crucial when sales people are working hard to close deals before the shot clock runs down on the fiscal quarter.

Another advantage: The supplier might well score points with customers for anticipating their needs and offering a solution for them.

A third advantage: Some customers are far less *price*-sensitive than they are *service*-sensitive: They're willing to pay more if they feel they're getting premium treatment.

**Maybe it's is worth the risk?** The supplier and its lawyer should assess the actual business risk of agreeing to the customer's request — in the real world it might not be as big a problem as the supplier imagines.

(It's the *client's* call, of course.)

## 11.8 Terms to avoid

### 11.8.1 Reduce - better than "minimize"

A cautious drafting approach is to use the term *reduce* in lieu of *minimize*, against the chance that an adversary might later claim that "minimization" didn't actually occur, i.e., that the reduction that was actually achieved was not the greatest amount of reduction possible.

(Ditto for using the term *increase,* or *enhance,* in lieu of *maximize*.)

### 11.8.2 True and correct *[sic]*: Don't

You might see contract language such as (hypothetically): "ABC certifies that each statement in its request for expense reimbursement is *true and correct*." What does that mean, exactly?

The present author doesn't like stating that a report, etc., must be "true and correct" because:

- The phrase is arguably redundant — is there a difference between *true* and *correct*? If so, what is that difference? (To paraphrase a former student of the present author: That's a conversation we don't want to have.)
- The phrase arguably doesn't go far enough: Let's assume that the statement: *Jane was in the room* is accurate, in that Jane was indeed in the meeting. Does that make the statement "true" or "correct" if others were also in the room?

In the present author's view, the phrase *complete and accurate* does the job better.

### 11.8.3 "Provided, that …": Don't. Just don't

Take a look at section 2.15 of the contract by which Verizon took over Yahoo: It makes you want to cry out, "My kingdom for a period!"

> (a) (i) Each material lease or sublease (a "Lease") pursuant to which Seller (to the extent related to the Business) or any of the Business Subsidiaries leases or subleases real property (excluding all leases or subleases for data centers) (the "Leased Real Property") is in full force and effect and Seller or the applicable Business Subsidiary has good and valid leasehold title in each parcel of the Leased Real Property pursuant to such Lease, free and clear of all Encumbrances other than Permitted Encumbrances, except in each case where such failure would not, individually or in the aggregate, reasonably be expected to have a Business Material Adverse Effect and (ii) there are no defaults by Seller or a Business Subsidiary (or any conditions or events that, after notice or the lapse of time or both, would constitute a default by Seller or a Business Subsidiary) and to the Knowledge of Seller, there are no defaults by any other party to such Lease (or any conditions or events that, after notice or the lapse of time or both, would constitute a default by such other party) under such Lease, except where such defaults would not, individually or in the aggregate, reasonably be expected to have a Business Material Adverse Effect.

> Stock Purchase Agreement by and among Yahoo! Inc. and Verizon Communications Inc. dated as of July 23, 2016, § 2.15.

It's reminiscent of early English translations of some of the Christian gospels, which literally translated the Greek conjunction και (*kai*, "and") instead of using it as a separator, almost a punctuation mark, as the authors did — which led to some interesting run-on translations.

> See, e.g., Multifunctionality of δέ, τε, and και (chs.harvard.edu; undated).

See, for example, the Gospel of Mark, chapter 10, verses 33-34, in an almost-literal, word-for-word translation from the Greek "original":

> Lo, we go up to Jerusalem and the Son of Man shall be delivered to the chief priests and to the scribes and they shall condemn him to death and shall deliver him to the nations and they shall mock him and scourge him and spit on him and kill him and the third day he shall rise again.

(Emphasis added.) The King James Version's translation of that passage, published in 1611, didn't change much:

> Saying, Behold, we go up to Jerusalem; and the Son of man shall be delivered unto the chief priests, and unto the scribes; and they shall condemn him to death, and shall deliver him to the Gentiles:
>
> And they shall mock him, and shall scourge him, and shall spit upon him, and shall kill him: and the third day he shall rise again.

Contrast the above translations with the modern New International Version (NIV) translation of the same passage:

> "We are going up to Jerusalem," he said, "and the Son of Man will be delivered over to the chief priests and the teachers of the law. They will condemn him to death and will hand him over to the Gentiles, who will mock him and spit on him, flog him and kill him. Three days later he will rise."

The modern translation seems much more readable, right?

Go ye and do likewise ….

### 11.8.4 Consummated - not a great word (commentary)

**Caution:** Be careful about using terms such as "*consummated*" sales — that led to what must have been an expensive lawsuit over a finder's fee: the court ruled that a finder's-fee agreement did not require the resulting federal contract to be "performed" in order for the transaction to be "consummated"; the finder's fee was therefore due and owing.

> See Fed Cetera, LLC v. Nat'l Credit Servs., Inc., 938 F.3d 466 (3d Cir. 2019).

# Chapter 12 Litigation planning

Very, very few contracts end up in litigation. But drafting for litigation anyway —

- signals The Other Side that you possess some street smarts; and
- can come in handy if the parties get into a dispute.

## 12.1 Draft the preamble to help out trial counsel

See Section 3.5: , "Preamble: Front-load some useful information."

## 12.2 Use bright-line standards for significant triggers

Vague language can *sometimes* lead to trouble if the vagueness can lead to disputes *about whether particular rights or obligations have been triggered*. Here are a couple of examples:

• It's better to refer to the contract's being "signed" instead of "executed," because the latter could be interpreted as the contract's being *performed* by the parties; this happened in a Delaware case.

> See Akorn, Inc. v. Fresenius Kabi AG, No. 2018–0300–JTL, text accompanying n.333 (Del. Ch. Ct. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018).

• A particular referral agreement stated that a referring party would be paid a commission by a supplier whenever the supplier "consummated" a transaction with a referred customer during a stated time period. For one referred transaction, the supplier signed a contract with a referred customer during the stated time period, but nothing else happened until after the time period had ended. This led to litigation whether the transaction had been "consummated" during the time period, and thus whether the referring party was entitled to a commission for that transaction.

> See Fed Cetera, LLC v. Nat'l Credit Servs., Inc., 938 F.3d 466 (3d Cir. 2019) (reversing and remanding summary judgment).

*Lesson:* Refer to a more-certain date, such as: • the date the contract was *signed*; • the date of the invoice; • the date payment was *collected*.

Likewise, don't write that notice must be "given" by a certain date; instead, say that notice must be "received" or "effective" (if effectiveness is defined) or "sent" by that date.

For situations where bright-line standards aren't practicable (or desired), consider: • "baseball arbitration" determination of disputes to promote settlement, where the arbitrator's only power is to pick one or the other of the parties' respective final proposals — this provides a powerful incentive for each party to be reasonable; or • expert determinations, as often seen in construction contracts.

> See, e.g., Peter Godwin, David Gilmore, Emma Kratochvilova, Mike McClure, and Conal McFadyen, *Expert Determination: What, When And Why?*, at https://perma.cc/2NJN-GHS2 (Mondaq.com 2017).

## 12.3 Acknowledgements: Like an admission in court

An *acknowledgement* is tantamount to an admission under the (U.S.) Federal Rules of Civil Procedure.

> Fed. R. Civ. P. 36(b). Tango Clause 22.1 - Acknowledgement Effect makes this explicit.

Apropos of this subject, California Evidence Code § 622 provides: "The facts recited in a written instrument *are conclusively presumed to be true* as between the parties thereto, or their successors in interest; but this rule does not apply to the recital of a consideration." (Emphasis added.)

### 12.3.1 An example

Imagine that you are negotiating a patent-license agreement with a patent owner:

- In the license agreement, you "acknowledge" that one of your company's products is covered by the other party's patent, which means that you must pay royalties to the patent owner for your sales of that particular product.
- But later you conclude that your product in question actually isn't covered by the patent after all. You decide that you needn't pay those particular royalties to the patent owner after all.

You might be out of luck: Your acknowledgement of patent coverage in the license agreement might well block you from taking a different position later. That's essentially what happened in a Tenth Circuit case.

> See Cellport Sys., Inc. v. Peiker Acustic GmbH & Co., KG, 762 F.3d 1016, 1022 (10th Cir. 2014) (reversing and remanding trial-court judgment in part).

### 12.3.2 Words other than "acknowledge" can have that effect

In an Eighth Circuit decision, an investment bank's client agreement included a first-person statement in which the client said, "**I agree** that all transactions with respect to any such Account shall be subject to the following terms," and those terms included that transactions would be "subject to" external rules, including FINRA rules. The Eighth Circuit agreed with the Second Circuit that this "I agree" and "subject to" language was an *acknowledgement* that put the client on notice of how transactions would be handled but *didn't* constitute a contractual *commitment* by the bank to do so.

> See Luis v. RBC Capital Markets, LLC, No. 19-2706, slip op. at 7, 9, 11 (8th Cir. Dec. 28, 2020) (affirming summary judgment dismissing clients' breach-of-contract claims against bank; citing numerous cases).

### 12.3.3 Pro tip: Don't be a jerk in asking for acknowledgements

Acknowledgements can be useful to establish facts for future litigation … but don't be a jerk about it. Some inexperienced drafters include statements in which another party "acknowledges" a supposed fact that would be against that party's interest.

Here's an overreaching example that's sometimes seen in confidentiality agreements: "*Recipient acknowledges that Discloser would be irreparably harmed by a breach or threatened breach of Recipient's confidentiality obligations under this Agreement.*" (The intent here is presumably for Recipient to waive Discloser's burden of proof in seeking a preliminary injunction or comparable relief; see [NONE] and its commentary.) Most Recipient counsel would probably:

- delete this equitable-relief acknowledgement entirely, or
- change "*would* be …" to "*could* be irreparably harmed"; and
- be irritated at Discloser's counsel for the obnoxious drafting.

## 12.4 Consider contract clauses to promote settlement

Business relationships can be fragile things. When drafting a contract, it can be useful to include specific provisions to reduce the odds that a dispute will cause the parties to drift helplessly into a lawsuit, such as:

• **Status-review conference calls upon request:** Many business-contract disputes could be avoided if the participants would just talk with each other every now and then, so strongly consider including such a requirement in the contract.

> See the Tango Terms "Status Conferences" provisions for an example.

• **Consultation in lieu of consent:** Sudden, unexpected moves by one party to a contract can make the other party nervous. For example, the business relationship between a service provider and a customer could be damaged if the service provider were to suddenly replace a key person assigned to the customer's work without notice.

The usual, sledge-hammer approach to dealing with this problem is to contractually require the provider to obtain the customer's prior *consent* before taking such an action. The provider, though, will usually push back against such a consent requirement — the provider will be reluctant to give the customer a veto over how it runs its business. Moreover, it could be a management burden for the provider to have to check every customer's contract to see what internal management decisions required prior customer approval.

As an alternative (and compromise), the provider might be willing to commit to *consulting* with the customer before taking a specified action that could cause heartburn for the customer. That way, the customer would at least get notice, perhaps an explanation, and an opportunity to be heard, which could make a big difference in the customer's reaction and to the parties' business relationship.

*Example:* A services contract could say that, for example, "Except in cases of emergency, Service Provider will consult with Customer at least ten business days in advance of replacing Service Provider's supervisor in charge of the Project." That would at least get the parties talking to one another, which can help avoid strains in their business relationship.

(Of course, a party must also keep track of its consultation commitments, just as much as its consent obligations.)

• **Dispute management:** Strongly consider including the provisions such as the Tango Terms dispute-management clauses, for the reasons discussed in the commentary there.

## 12.5 Litigation prep: Include "demonstrative exhibits"?

Remember the cliché about a picture being worth a thousand words? Nowhere is that more true than the courtroom. That's why in litigation, lawyers and expert witnesses often use so-called demonstrative exhibits — diagrams, time lines, charts, tables, sketches, etc., on posters or PowerPoint slides — as teaching aids to help them get their points across to the jury during testimony and argument.

In a lawsuit, the jurors might or might not be allowed to refer to the parties' demonstrative aids while they're deliberating.

• Jurors normally take "real" exhibits — like a copy of the contract in suit — into the jury room with them and refer to them during deliberations.

• Judges, however, sometimes won't allow the jury to take *demonstrative* exhibits with them, on the theory that the jurors are supposed to decide the case on the basis of the "real" evidence and not on documents created solely for litigation by the lawyers. True, in U.S. federal-court cases, Rule 1006 of the Federal Rules of Evidence allows summaries and the like to be admitted into evidence. Trial judges, however, have significant discretion over evidentiary matters; if a particular judge were to decide that a particular demonstrative aid should not be given to the jury for use in its deliberations, that'd normally the end of that discussion.

> See, e.g., Allen Hinderaker & Ian McFarland, Demonstrative Evidence Under the Rules: The Admissable and Inadmissable (MerchantGould.com 2015), *discussing* Fed. R. Evid. 611 and 1006.

So: If you plan ahead when drafting a contract, your client's trial counsel might later be able to sneak a demonstrative aid or two into the jury room through the back door — no, through the front door, but at the back of the contract — *as "real" evidence, not just as a demonstrative exhibit*, to help the jurors understand what the parties agreed to.

Ask yourself: *Is there anything we'd want the jurors to have tacked up on the wall in the jury room* — for example, a time line of a complex set of obligations? If so, think about creating that time line now, and including it as an exhibit to the contract. The exhibit will ordinarily count as part of the "real" evidence; it should normally be allowed back into the jury room without a fuss.

Of course, before the contract is signed the parties would have to agree to include your stealth demonstrative exhibit in the contract document. But their reviewing your exhibit for correctness could be a worthwhile exercise — and if their review makes them realize they don't agree about something, it's usually better if they find that out before they sign.

And to be sure, there's always the risk of unintended consequences: The demonstrative exhibit you create today might not create the impression you want to create in a jury room years from now. But that's always a risk even when you write the contract itself.

Your time line, chart, summary, diagram, etc., doesn't necessarily have to be a separate exhibit: modern word processors make it simple to include such things as insets within the body of the contract. (The author used to do just that when writing patent-invalidity or -noninfringement opinions: I'd prepare the PowerPoint slides that I'd want to use if I were testifying as an expert witness, and then I'd insert those slides as insets in the body of the opinion itself.)

## 12.6 Remember the burden of proof in contract enforcement

Contract drafters should keep in the back of their minds that contract *enforcement* might come down to whether a trier of fact will be persuaded by a party's claim: • If "Alice" claims that "Bob" breached a contract, then Alice must convince the jury — or the judge, in a non-jury "bench" trial, or arbitration tribunal, if applicable — that Bob *in fact* did something that was a breach. • Conversely: Bob might claim, as an affirmative defense, that even if he did breach, the breach was justified by, say, Alice's own breach, and so he should not be held liable for his own breach. In that situation, it's up to Bob to persuade the jury, etc., that Alice *in fact* did something that was a breach on her part.

Here's where it can get important: Suppose that — based on the evidence that was admitted at trial — *reasonable* people could go either way about whether Bob did or didn't do what Alice claimed he did. When that occurs, the jury's or judge's finding on the point is pretty much unassailable (and even more so in arbitration cases).

(The same is true for Bob's affirmative defense: If Bob fails to persuade the trier of fact that Alice did what Bob claims, then Bob loses on that defense.)

The Fifth Circuit illustrated this point in a trade-secret case, where a company's former employee and his new firm claimed that the company was using a trade secret, owned by the former employee, without authorization. The company denied that it was using the trade secret. In a non-jury trial, the trial judge ruled that the plaintiffs had not proved their case — i.e., had not persuaded the trial judge that the defendant company was *in fact* using the trade secret. The appeals court affirmed because the trial judge's finding was not clearly mistaken: "… *it was unclear to the district court, as it is unclear to us*, how a gas and a chemical compound commonly used in lamps and lasers can be a trade secret. … We conclude that Olstowski and ATOM's proclaimed legal issue is indeed a factual one, and that *they failed to carry their burden of proof at trial*.

> ATOM Instrument Corp. v. Petroleum Analyzer Co., 969 F.3d 210, 216 (5th Cir. 2020) (emphasis added).

Another example: A digital ad agency and an e-cigarette manufacturer entered into a contract for the ad agency to place online ads. The manufacturer refused to pay a large invoice from the ad agency because, the manufacturer said, it had not received an itemized invoice that would allow the manufacturer to check for misleading ads and click-fraud. The contract, however, had addressed this, stating that the manufacturer could get out of its payment obligations only if the manufacturer provided the ad agency with documentary evidence "proving fraud beyond a reasonable doubt[.]" The manufacturer was held liable to the ad agency for more than a million dollars in unpaid ad fees.

> See CX Digital Media, Inc. v. Smoking Everywhere, Inc., No. 09-62020-CIV, slip op. at 12 (S.D. Fla. Mar. 23, 2011).

The drafting lesson: Consider trying to phrase contract obligations to put the burden of proof on the other party. Here's a grossly-simplified hypothetical example:

- Consider the phrase: *Bob will bill Alice for his services at $X per hour, but Alice need not pay Bob if it does not rain on Sunday*. The "default" position here is that if Alice doesn't want to pay Bob, *she must prove* that it didn't rain on Sunday.

- In contrast, consider the phrase: *Alice must pay Bob for his services at the rate of $X per hour if it rains on Sunday*. This wording suggests that if Bob wants to get paid, *it's up to him* to prove that it *did* rain on Sunday.

Tangentially related: The Tango Terms expense-reimbursement language prohibits a party incurring expenses *from even submitting* reimbursement requests for ineligible expenses. The idea is to forbid the incurring party from brazenly billing the reimbursing party for *ineligible* expenses, and then writing off the charge with a shrug and a smirk if the reimbursing party spots the improper charge and refuses to pay it. If the Tango Terms language said merely that the incurring party *had no obligation to pay* ineligible expenses, it would put the burden on the reimbursing party to pay closer attention to the incurring party's invoices.

## 12.7 Watch out for "optics"

In a past semester, a student wrote: "The parties *agree and acknowledge* that Gigunda *will not liable* for a breach of warranty and/or misrepresentation." (Emphasis added.) Two comments:

1. "The parties agree and acknowledge" isn't a good way to phrase anything — just say "Gigunda will not be liable …."

2. More importantly: For "optics" purposes, Gigunda might want to say instead that its *liability* for breach is limited to some low figure such as, say, $100.

## 12.8 Exercise: Acknowledgement

1. What does it mean to "acknowledge" something, and why might it be dangerous?

2. Cite (or make up) an example of how acknowledging something in a contract might be dangerous (other than the example in the reading above).

# Chapter 13 Representations and warranties

Contents:



## 13.1 Introduction

When parties do business together, each party generally presupposes that certain things were true in the past, or are true now, or will be true at some point in the future. But sometimes those presuppositions turn out to be wrong.

With that in mind, it's often prudent for parties to divide up *the responsibility for making sure* that specified things were — or are — or will be — as planned. This can include provisions for parties *representing* certain things and/or *warranting* certain things, as discussed in this chapter.

Each representation or warranty does two things:

1. sets out a particular factual state of affairs that one party (or both) *wants* to be true; and

2. allocates, as between the parties, the risk that the state of affairs might turn out *not* to be true.

But as discussed below, representations and warranties have different proof requirements and, upon proof, different available remedies.

## 13.2 What *is* a "representation"? A "warranty"?

A **representation** is generally understood as:

- a statement of *past*- or *present* fact,
- made to one or more specified other parties,
- in connection with:
    - the Contract, or
    - a matter relating to:
        - (i) the Contract, and/or
        - (ii) a transaction or relationship resulting from the Contract.

> The "past or present fact" formulation is suggested by Professor Tina Stark in her highly-regarded Drafting Contracts textbook. ¶ The term *transaction or relationship* term is modeled on an arbitration provision that was litigated in both the Fifth and Eleventh Circuits; see Sherer v. Green Tree Servicing LLC, 548 F.3d 379, 382-83 (5th Cir. 2008), *citing* Blinco v. Green Tree Servicing LLC, 400 F.3d 1308, 1310 (11th Cir. 2005). ¶ See also the Tango Terms definition of "representation."
>
> Special case: A representation could be a statement of *future* fact **IF** the future fact is uniquely within the control of the representing party — for example, if Alice owes money to Bob, Alice might *represent* that she will pay Bob on a particular date. (**Rule:** Don't do action commitments like this as *representations*; they should be *promises*, i.e., covenants, as discussed in more detail in Section 13.6.1: below.)

Importantly: If the represented fact turns out not to be true, then the representing party could be liable, but only if certain additional facts are proved, as discussed below; this differs significantly from if the representing party had also *warranted* the represented fact.

A **warranty** is much like a representation, except that:

- a warranty concerns one or more past, present, *and/or future* facts; and
- the warranting party promises to take specified actions if the warranted fact is shown not to be true — if no particular action is specified, then the warranting party reimburses the warranty beneficiary for any damages incurred by the latter as a result of the untruth.

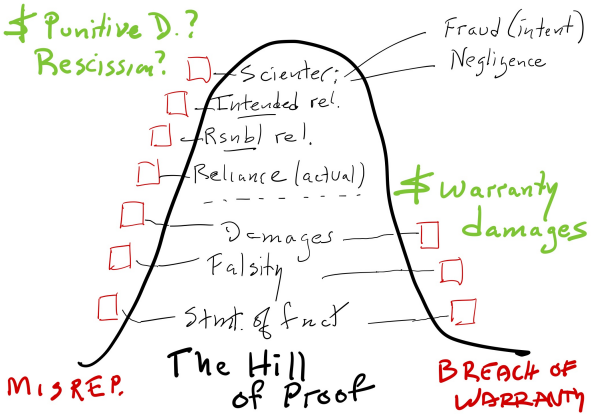
## 13.3 Ninja Warrior: Two paths up "The Hill of Proof"

Let's consider a hypothetical example: Alice wants to sell her car to Bob; suppose that she *represents* — or perhaps warrants, or perhaps both — that her

car has never been in an accident *[past fact]* and is in good working order *[present fact]*.

But now suppose that after Bob takes delivery of the car and drives it, he learns that it has significant mechanical problems, and he wants to sue Alice (probably in small-claims court) for damages. To help visualize how this works, think in terms of the American Ninja Warrior TV show, with an evidentiary "Hill of Proof" that Bob must climb in making his claim(s) against Alice:

- As plaintiff, Bob starts out at the bottom of the Hill of Proof, equidistant between the "representation" claim on the left side of the hill and the "warranty" claim on the right side.
- As Bob clambers up the Hill of Proof, he tries to "hit" various evidentiary checkpoints along the way, with his left hand (on the representation-claim side) or his right hand (on the warranty-claim side).
- The "prizes," i.e., the remedies available to Bob, are positioned at different points up the hill.




("The Hill of Proof" sounds like something from a Harry Potter novel, no?)

### 13.3.1 Breach of warranty: Less for Bob to prove — but fewer remedies

As seen on the *right* side of the Hill of Proof, if Bob sues Alice for *breach of warranty*, he needn't show reasonable reliance nor scienter, but simply that (i) a warranty was made, (ii) a warranted fact proved untrue, and (iii) Bob suffered damages as a result. A leading case on point is *CBS v. Ziff-Davis*, from the Court of Appeals of New York (that state's highest court), which in essence characterized a warranty as a kind of conditional covenant, akin to an insurance policy, a contractual commitment to assume certain risks:

> [A warranty is] **an assurance** by one party to a contract of the existence of a fact upon which **the other party may rely**.

> It is intended precisely to relieve the promisee of any duty to ascertain the fact for himself[.]
>
> [I]t amounts to **a promise to indemnify the promisee** for any loss if the fact warranted proves untrue ….

CBS, Inc. v. Ziff-Davis Publishing Co., 75 N.Y.2d 496, 503, 553 N.E.2d 997, 1001 (1990), *quoting* Metropolitan Coal Co. v Howard, 155 F.2d 780, 784 (2d Cir 1946) (Learned Hand, J.) (emphasis by the *Ziff-Davis* court edited, extra paragraphing added). See also Lyon Fin. Serv., Inc. v. Illinois Paper & Copier Co., 848 N.W.2d 539, 543-46 (Minn. 2014) (on certification from 7th Cir.), where Minnesota's supreme court held that proof of reliance was not required for a breach of *contract* action, but the court declined to decide whether such proof was still required for a breach of *warranty* claim (the only pleaded action in the case).

In other words: If Bob successfully shows breach of *warranty*, on the right side of the Hill of Proof, that's enough to entitle him to breach-of-warranty damages — generally, either (i) the cost of fixing the car's problems, or if that's not economically feasible, then (ii) the difference between the value of the car Bob actually received versus the value of the car he bargained for.

Concerning damages for breach, see generally Hawkins v. McGee, 84 N.H. 114, 146 A. 641 (1929) (the "hairy hand" case).

In another case, the Seventh Circuit, applying Illinois law, held that: "The warranty sued on here was part of the parties' agreement, so the plaintiff did not need to prove further reliance."

Abellan v. Lavelo Prop. Mgmt. LLC, 948 F.3d 820, 832-33 (7th Cir. 2020), *citing*, among others, *CBS v. Ziff-Davis.* See generally Matthew J. Duchemin, Whether Reliance on the Warranty is Required in a Common Law Action for Breach of an Express Warranty, 82 Marq. L. Rev. 689 (1999).

Footnote: A different situation might be presented, however, if — before the contract was signed — *the warranting party disclosed* that a warranty was inaccurate. While the law seems still to be evolving in this area, the influential U.S. Court of Appeals for the Second Circuit once summarized New York law thusly:

> [W]here *the seller* discloses up front the inaccuracy of certain of his warranties, it cannot be said that the buyer — absent the express preservation of his rights — believed he was purchasing the seller's promise as to the truth of the warranties.
>
> Accordingly, what the buyer knew *and, most importantly, whether he got that knowledge from the seller* are the critical questions.

Rogath v. Siebenmann, 129 F.3d 261, 264-65 (2d Cir. 1997) (vacating and remanding partial summary judgment that seller had breached contract warranty; emphasis and extra paragraphing added).

### 13.3.2 Breach of *warranty* vs. breach of *contract*

The Fifth Circuit explained the difference between a breach of contract and a breach of warranty (under the Texas version of article 2 of the Uniform Commercial Code):

> Breach of contract and warranty claims are distinct causes of action under Texas law and provide for different remedies, and Texas law forbids conflating breach of warranty and breach of contract.
>
> A breach of **contract** claim exists when a party **fails to deliver** the goods as promised. Damages are only permitted under a breach of contract cause of action when [i] the seller has failed to deliver the goods, [ii] the buyer has rejected the goods, or [iii] the buyer has revoked his acceptance.
>
> - Texas law allows a buyer to revoke acceptance of a good if the good was accepted without knowledge of the nonconformity and `acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurance.
> - If a buyer retains and uses, alters, or changes the goods, it will be found to have accepted them. …
>
> [A] breach of **warranty** claim … arises when a seller delivers **nonconforming** goods.
>
> The UCC recognizes that breach of contract and breach of warranty are not the same cause of action.
>
> The remedies for breach of contract are set forth in Texas Business and Commerce Code section 2.711, and are available to a buyer where the seller fails to make delivery.
>
> The remedies for breach of warranty, however, are set forth in section 2.714, and are available to a buyer who has finally accepted goods, but discovers the goods are defective in some manner.
>
> Thus, **the critical factor** in whether the buyer has a breach of *contract* or breach of *warranty* claim is whether the buyer has finally accepted the goods.
>
> Baker Hughes Process & Pipeline v. UE Compression, L.L.C., 938 F.3d 661, 666-67 (5th Cir. 2019) (affirming summary judgment dismissing Baker Hughes's claims) (formatting altered).

### 13.3.3 Misrepresentation: Bob's extra proof requirements

It's a different story on the *upper left* side of the Hill of Proof: If Bob wants to sue Alice for *misrepresentation*, he must show:

1. that Bob *in fact* **relied** on Alice's representation; that usually won't be a heavy burden if that representation is explicitly stated in the contract — and in fact one state's supreme court has held that "a claim for breach of

a *contractual* representation of future legal compliance is actionable under Minnesota law without proof of reliance."

> Lyon Fin. Serv., Inc. v. Illinois Paper & Copier Co., 848 N.W.2d 539, 540 (Minn. 2014) (on certification from 7th Circuit) (emphasis added).

2. that Bob's reliance on Alice's representation was **reasonable** under the circumstances; reasonableness of reliance would likely be presumed, but reliance could be *un*reasonable if the representation was obviously false or misleading when made; and

3. that Alice acted **negligently**, or recklessly, or even intentionally (i.e., fraudulently), in making the (mis)representation — i.e,. he must show that Alice acted with **scienter**.

If Bob can prove these additional elements, over and above the elements required for breach of warranty, then he might well be entitled to tort-like remedies such as punitive damages and/or rescission of the contract, neither of which is normally available for a simple breach of warranty.

> Rescission *might* be available under the Uniform Commercial Code if it applied and the facts were such that Bob was entitled to revoke his acceptance of the car; that possibility is beyond the scope of this discussion.

Authority: As to *negligent* misrepresentation:

> … under New York law, the plaintiff must allege that (1) the defendant had a duty, as a result of a special relationship *[such as privity of contract–DCT]*, to give correct information; (2) the defendant made a false representation that he or she should have known was incorrect; (3) the information supplied in the representation was known by the defendant to be desired by the plaintiff for a serious purpose; (4) the plaintiff intended to rely and act upon it; and (5) the plaintiff reasonably relied on it to his or her detriment.

> Anschutz Corp. v. Merrill Lynch & Co., 690 F.3d 98, 114 (2d Cir. 2012) (granting motion to dismiss claim of negligent-misrepresentation; cleaned up, citations omitted), *quoted in* Kortright Capital Partners LP v. Investcorp Investment Advisers Ltd., 257 F. Supp. 3d 348, 355 (S.D.N.Y. 2017) (denying motion to dismiss claims of negligent misrepresentation).

Somewhat similarly, in Texas as in many other states, the courts follow Restatement (Second) of Torts § 552 (1977) in defining negligent misrepresentation as:

> (1) the representation is made by a defendant in the course of his business, or in a transaction in which he has a pecuniary interest;
>
> (2) the defendant supplies 'false information' for the guidance of others in their business;

> (3) the defendant did not exercise reasonable care or competence in obtaining or communicating the information; and
>
> (4) the plaintiff suffers pecuniary loss by justifiably relying on the representation."

Federal Land Bank Ass'n of Tyler v. Sloane, 825 S.W.2d 439, 442 (Tex. 1991) (affirming judgment for prospective borrowers on jury verdict of negligent misrepresentation by bank loan officer; extra paragraphing added), *followed in* McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests, 991 S.W.2d 787, 791 (Tex. 1999) (claim against attorneys by non-client) *and* Grant Thornton LLP v. Prospect High Income Fund, 314 SW 3d 913, 920 (Tex. 2010) (investors' claim against auditors).

It bears noting that "California courts have expressly rejected that requirement [of privity of contract or other a special relationship], holding that negligent misrepresentation claims may be brought against any person who negligently supplies false information for the guidance of others in their business transactions and intends to supply the information for the benefit of one or more third parties."

Anschutz Corp., 690 F.3d at 113 (cleaned up; emphasis added).

**As to fraud**, New York law is fairly typical: "The elements of a cause of action for fraud require a material misrepresentation of a fact, knowledge of its falsity, an intent to induce reliance, justifiable reliance by the plaintiff and damages."

Eurycleia Partners, LP v. Seward & Kissel, LLP, 12 N.Y.3d 553, 559, 910 N.E.2d 976, 883 N.Y.S.2d 147 (2009) (citations omitted).

Similarly, under Texas law:

> The elements of fraud are:
>
> (1) that a material representation was made;
>
> (2) the representation was false;
>
> (3) when the representation was made, the speaker **knew** it was false **or** made it recklessly **without** any knowledge of the truth and as a positive assertion;
>
> (4) the speaker made the representation with the **intent** that the other party should act upon it;
>
> (5) the party acted in reliance on the representation; and
>
> (6) the party thereby suffered injury.

Italian Cowboy Partners, Ltd. v. Prudential Ins. Co., 341 S.W. 3d 323, 337 (Tex. 2011) (emphasis and extra paragraphing added, citation omitted). **Note the absence here** of a requirement that the plaintiff prove that the reliance was justified or reasonable.

If Bob successfully proves his claim of misrepresentation against Alice, then he *could* be entitled to tort-style remedies such as punitive damages and/or rescission of the contract.

## 13.4 Implied warranties: Disclaimers

If you've ever even partially read a contract, such as the online "terms of service" for a Website, you've almost certainly seen disclaimers of (implied) warranties.

### 13.4.1 Examples of specific disclaimers

A contract could state that its disclaimer of implied warranties has the effect of disclaiming — without limitation — any and all implied warranties, etc., concerning the following matters:

1. merchantability of goods — see the definition of "merchantability in UCC § 2-314; such a disclaimer should be in bold or all-caps to make it "conspicuous" as required by UCC § 2-316;

2. fitness of goods for a particular purpose, whether or not the disclaiming party or any of its suppliers or affiliates know, have reason to know, have been advised, or are otherwise in fact aware of any such purpose — any such disclaimer should also be in bold or all-caps to make it "conspicuous" as required by UCC § 2-316;

3. quiet enjoyment — this relates mainly to real property;

4. title — UCC § 2-312 includes specific requirements for a disclaimer of this implied warranty;

5. noninfringement — see the (limited) implied warranty in UCC § 2-312; many contracts where this is relevant will include an *express* warranty of noninfringement with specific remedies, such as in [NONE];

6. absence of viruses or other malware in software;

7. results;

8. workmanlike performance or -effort — see the discussion in the commentary to [NONE];

9. quality — this disclaimer is a UK formulation, discussed in § 13.4.5;

10. non-interference;

11. accuracy of content;

12. correspondence to description — This is a UK formulation roughly analogous to the implied warranty of merchantability in subdivision 1 above.

### 13.4.2 Implied warranties for sales of *goods* can arise automatically

In the U.S., article 2 of the Uniform Commercial Code (adopted in all states except Louisiana) provides a number of *implied* warranties that sellers are deemed to make when they sell "goods," namely the following:

- an implied warranty of clean **title**, "free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge," under § 2-312(1);
- an implied warranty of **noninfringement** of third-party rights, under § 2-312(3) —
    - but only if the seller is "a merchant regularly dealing in goods of the kind";
    - and with an exception if the buyer furnishes specifications and the infringement;
- an implied warranty of **merchantability**, under § 2-314, with a definition that could be paraphrased as, in essence, goods that a reputable merchant would be willing to offer to the public under the contract description; and
- an implied warranty of **fitness for the buyer's particular purpose**, under § 2-315, but only if "the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods …."; whether this prerequisite was met, of course, could be a disputed fact issue, resulting in expensive litigation.

UCC implied warranties can be disclaimed, as discussed in § 13.4.4.

### 13.4.3 Some *services* might come with implied warranties

This is discussed in the commentary to [NONE] (performance standards for services).

### 13.4.4 UCC implied warranties for goods can be disclaimed

In the (U.S.) Uniform Commercial Code, section 2-316 (governing sales of goods) specifically allows sellers to disclaim warranties that are not expressly stated in the contract, with some limits:

> (2) Subject to subsection (3), to exclude or modify the implied warranty of **merchantability** or any part of it the language must mention merchantability
>
> and in case of a writing must be **conspicuous**,
>
> and to exclude or modify any implied warranty of **fitness** the exclusion must be by **a writing *and* conspicuous**.

> Language to exclude all implied warranties of fitness is **sufficient** if it states, for example, that "There are no warranties which extend beyond the description on the face hereof."
>
> (3) Notwithstanding subsection (2)
>
> (a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "**as is**", "with all faults" or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty; and
>
> (b) when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and
>
> (c) an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.

(Emphasis and extra paragraphing added.)

**Caution:** A special case is the warranty of *title*: UCC § 2-312, which requires that any disclaimer of the automatic warranty of **title** must be expressly stated. From a business perspective this makes sense, of course; as an example, even if Alice were to sell Bob a car "as is," Bob should still be entitled to assume that Alice isn't trying to sell him stolen property.

### 13.4.5 (UK:) Disclaiming only implied *warranties* isn't enough

A vendor doing a sales transaction under UK law (England, Wales, Northern Ireland) will want to be sure to disclaim not only implied *warranties* but also implied *conditions* and implied *terms of quality*. An oil seller failed to do so and learned that its disclaimer of implied *warranties* didn't shield it from liability.

> See KG Bominflot Bunkergesellschaft Für Mineralöle mbh & Co KG v. Petroplus Marketing AG, [2009] EWHC 1088, ¶ 49 (Comm).

### 13.4.6 *Representations* can be *deemed* to be UCC *warranties*

Suppose that in a contract *for the sale of goods* in the U.S., the seller only *represents* that Fact X is true, without using the word *warranty*: That representation can itself be a warranty, because under UCC § 2-313(1):

> (a) *Any affirmation of fact* or promise made by the seller to the buyer
>
> - which relates to the goods
> - and becomes part of *the basis of the bargain*
>
> creates an express warranty that the goods shall conform to the affirmation or promise.

> (b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.
>
> (c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

(Emphasis and extra paragraphing added.)

Of course, it might be hotly disputed whether "the basis of the bargain" included a particular affirmation of fact, description of the goods, or sample or model.

Because the representation is (putatively) an *express* warranty, it likely can't be "disclaimed" as such (but see the next section about waiver of reliance on representations).

## 13.5 "Disclaiming" external representations

Disclaiming a *representation* requires a bit more work than disclaiming an implied warranty. That's generally because, for obvious reasons, a court is likely to be reluctant to let a party off the hook if it appears that the party was untruthful or simply negligent in what it said to another party.

What drafters do to (try to) preclude later claims of misrepresentation is to include reliance waivers, such as that in [NONE].

### 13.5.1 Legal background: Fraudulent inducement - "they lied!"

In a contract dispute, an aggrieved party might well claim that another party "fraudulently induced" the aggrieved party into entering into the contract by making supposedly-false statements that weren't set out in the contract itself. Such claims, though, can turn a simple dispute into an expensive mess of a lawsuit. The above language seeks to forestall that possibility.

*Example:* If Hewlett-Packard's EDS subsidiary had included a no-reliance disclaimer clause in its software-system development agreement with British Sky Broadcasting, then perhaps it might not have had to pay some USD $ 460 million to settle Sky's successful claim for fraudulent inducement to enter into the agreement.

See BSkyB Ltd. v. HP Enterprise Services UK Ltd., [2010] EWHC 86 (TCC).

*Example:* A software developer found itself having to defend against a customer's claim that the developer had not only "breached its obligations under the contract … but also that *[the developer]* wrongfully induced *[the customer]* into entering a contractual relationship knowing that *[the developer]* did not have the capability to perform any of the promised web-related services." The Colorado supreme court held that those allegations "state a violation of a tort duty that is independent of the contract" and thus should not have been dismissed under the economic-loss doctrine.

See Van Rees v. Unleaded Software, Inc., 2016 CO 51 ¶ 19, 373 P.3d 603, 608 (Colo. 2016).

### 13.5.2 An entire-agreement clause might not be enough

Entire-agreement provisions (a.k.a. merger clauses or zipper clauses) often state, in effect: *Neither party makes any representations beyond those stated in this Agreement and its exhibits, attachments, and appendixes*. That might be enough in some jurisdictions.

For example, New York treats such no-other-representation disclaimers — *but only in specific circumstances,* such as a transaction between large, sophisticated parties — as inherently barring reliance on alleged external representations, and thus as barring claims of misrepresentation.

> See Century Pacific, Inc. v. Hilton Hotels Corp., 528 F. Supp. 2d 206, 229, 230-31 (S.D.N.Y 2007) (granting defendants' motion for summary judgment dismissing misrepresentation claims) (cleaned up, citations omitted, emphasis added), *aff'd*, No. 09-0545-cv, slip op. (2d Cir. Nov. 25, 2009) (summary order).

But in some other jurisdictions, merely stating that there *are* no other representations is not enough to avoid a claim of fraudulent inducement. Putting it another way: A no-representations clause alone would not necessarily defeat "they lied!" *Example:* The Supreme Court of Texas explained that under that state's law:

> Pure merger clauses, *without an expressed clear and unequivocal intent to disclaim reliance or waive claims for fraudulent inducement*, have never had the effect of precluding claims for fraudulent inducement. …
>
> There is a significant difference between a party[:]
>
> - disclaiming its reliance on certain representations, and therefore potentially relinquishing the right to pursue any claim for which reliance is an element, and
> - disclaiming the fact that no other representations were made.
>
> *[DCT comment: In the context of a fraudulent-inducement analysis, though, don't these two disclaimers logically amount to exactly the same thing? As explained further down in this excerpt, though, the Texas supreme court seems to have felt that a disclaimer of extrinsic representations, standing alone, wasn't sufficiently explicit and "in your face" to alert the other side about what it was being asked to give up.]*
>
> * * *
>
> We have repeatedly held that to disclaim reliance, parties must use clear and unequivocal language. this elevated requirement of precise language helps ensure that parties to a contract — even sophisticated parties represented by able attorneys — understand that the contract's terms disclaim reliance, such that the contract may be binding even if it was induced by fraud.
>
> Here, the contract language was not clear or unequivocal about disclaiming reliance. For instance, the term "rely" does not appear in any form, either in terms of relying on the other party's representations, or in relying solely on one's own judgment.
>
> This provision stands in stark contrast to provisions we have previously held were clear and unequivocal *[three-column table, contrasting different clauses, omitted]*.

> Italian Cowboy Partners, Ltd. v. Prudential Ins. Co., 341 S.W. 3d 323, 333-37 (Tex. 2011) (reversing court of appeals; merger clause did not preclude tenant's claim that landlord had fraudulently induced

agreement to lease by misrepresenting condition of property) (extra paragraphing and bullets added, citations and some internal quotation marks omitted).

*Example:* In a Wisconsin case, Bank of America sold a foreclosed home to a buyer, subject to an "as-is" disclaimer. The bank stated that it had "little or no direct knowledge" of problems, but in fact the bank knew that there were serious mold problems. The appeals court affirmed judgment on a jury verdict in favor of the buyer, saying that: "The 'as is' and exculpatory clauses in the parties' contract do not, as a matter of law, relieve the bank/seller of liability … for its deceptive representation in the contract which induced agreement to such terms.

Fricano v. Bank of America NA, 2016 WI App. 11, 366 Wis.2d 748, 875 N.W.2d 143, 146 (2015).

### 13.5.3 A *reliance* waiver *could* defeat a misrepresentation claim …

So, drafters worried about possible fraudulent-inducement claims often approach the problem from a different direction: Under the law in many U.S. jurisdictions, a contracting party that claims misrepresentation by the other side normally would have to prove, among other things, *that it reasonably relied* on the alleged misrepresentation. That gives the other side's contract drafter a reason to include a disclaimer of reliance.

Here's a hypothetical example: Suppose that the following takes place:

- Alice and Bob enter into a contract for Alice to sell Bob a house located several hundred miles away from either of them.
- In the contract, Alice *represents* to Bob that the house is in good condition, but does not *warrant* it.
- After the closing, the house turns out to be a wreck.

Even though Alice didn't warrant the condition of the house, Alice might be liable for misrepresentation. For Bob to succeed with a misrepresentation claim, though, he would have had to "hit the checkpoints" for some additional elements of proof: Bob would have to show (probably among other things) that he had *reasonably relied* on Alice's representation.

Of course, Bob might well have a powerful incentive to prove his reasonable reliance: If he could establish Alice's liability for misrepresentation, then he might be able (i) to rescind the contract, and/or (ii) perhaps even to recover punitive damages from Alice; neither remedy is normally available in a breach-of-warranty action.

And even more basically: In a complex business- or technology case, a non-expert fact finder, such as a judge or juror, might not fully understand the details of a case, but she probably *would* understand the simple claim "they lied!."

Alice will want to head off such accusations. So planning ahead, she will want to include, in the contract, a statement that Bob *isn't* relying on any representations by Alice. That way, if Bob were to sue Alice for misrepresentation, a judge might very well rely (so to speak) on the disclaimer and summarily toss out Bob's claim by dismissing it on the pleadings.

When a reliance disclaimer is sufficiently clear, and the contracting parties are big enough to take care of themselves, many courts might well give effect to the disclaimer under freedom-of-contract principles.

Examples:

• The Texas supreme court held that under Texas law, "a party may be liable in tort for fraudulently inducing another party to enter into a contract. But the party may avoid liability if the other party contractually disclaimed any reliance on the first party's fraudulent representations. Whether a party is liable in any particular case depends on the contract's language and the totality of the surrounding circumstances."

> IBM v. Lufkin Industries, LLC, 573 S.W.3d 224, 226 (Tex. 2019). The court held: "Specifically, courts must consider such factors as whether (1) the terms of the contract were negotiated, rather than boilerplate, and during negotiations the parties specifically discussed the issue which has become the topic of the subsequent dispute; (2) the complaining party was represented by counsel; (3) the parties dealt with each other at arm's length; (4) the parties were knowledgeable in business matters; and (5) the release language was clear." *Id.* at 229 (paragraphing omitted).

• The contract between an alarm-system company and its jewelry-store customer contained the following reliance disclaimer: "In executing the Agreement, Customer is not relying on any advice or advertisement of ADT." The Fifth Circuit held that this language "was sufficiently clear as to disclaim any reliance by plaintiffs on any alleged misrepresentation ADT made prior to Plaintiffs entering into the contract. Accordingly, Plaintiffs' fraudulent inducement claim is barred under Texas law."

> Shakeri v. ADT Security Services, Inc., 816 F.3d 283, 288, 296 (5th Cir. 2016) (per curiam).

• New York's highest court ruled that a fraud complaint should have been summarily dismissed, because "plaintiffs in the plainest language announced and stipulated that they were not relying on any representations as to the very matter as to which they now claim they were defrauded."

> Pappas v. Tzolis, 20 N.Y.3d 228, 233-34 (2012).

### 13.5.4 … but maybe not

Of course, fraud claims might survive even a no-reliance provision. Suppose that Alice claims that Bob misrepresented facts to induce Alice to enter ito a contract, *and that Bob's misrepresentation wasn't merely negligent, but intentional*. And suppose also that the contract contains a no-reliance clause. In that situation, Bob should not hold out much hope that a court would *summarily* toss out Alice's fraudulent-inducement claim against him; the judge might very well insist on a full trial.

> See generally Andrew M. Zeitlin & Alison P. Baker, At Liberty to Lie? the Viability of Fraud Claims after Disclaiming Reliance, Apr. 23, 2013; see also Neal A. Potischman, Stephen Salmon, Alyse L. Katz, John A. Bick, Kirtee Kapoor and Lawrence Portnoy, Will Anti-Reliance Provisions Preclude Extra-Contractual Fraud Claims? Answers Differ In Delaware, New York, And California (Mondaq.com 2016).

And a no-reliance clause in a contract might not enough to convince a court to toss out a fraudulent-inducement or negligent-misrepresentation claim, for example if the plaintiff was not "sophisticated" and/or was not represented by counsel in the transaction in question.

> See Carousel's Creamery, L.L.C. v. Marble Slab Creamery, Inc., 134 S.W.3d 385 (Tex. App.–Houston [1st Dist.] 2004) (reversing and remanding directed verdict for defendant on negligent-misrepresentation claim).

### 13.5.5 Reliance waivers in M&A agreements

In merger- and acquisition ("M&A") deals, reliance disclaimers are often used because one party, typically the seller,

> doesn't want to be deceived by the buyer into entering into an agreement (with agreed caps on liability) *based on something that may or may not have been said* by someone that is not written in the agreement, and of which the selling shareholders may not even be aware,
>
> and that the buyer may determine to use post closing to make a claim *not subject to the cap*.
>
> And this is particularly true for the private equity seller concerned about post closing certainty in distributing proceeds to its limited partners.

Glenn D. West, Private Equity Sellers Must View "Fraud Carve-outs" with a Gimlet-Eye, Weil *Insights*, Weil's Global Private Equity Watch (2016) (emphasis and extra paragraphing added).

Delaware courts are likely to hold parties to the terms of their non-reliance disclaimers — "[b]ut even when fraud claims premised upon extra-contractual representations have been precluded by a non-reliance clause, *the express written representations* can sometimes provide a basis for a claim of fraud, at least at the motion to dismiss stage."

See Glenn D. West, Recent Delaware Cases Illustrating How Uncapped Fraud Claims Can and Cannot Be Premised Upon Written Representations (PrivateEquity.Weil.com 2020) (emphasis added).

### 13.5.6 Drafting tip: Be specific about what's disclaimed?

Courts seem to have more sympathy for a reliance disclaimer if, in the words of a Second Circuit opinion, the disclaimer "tracks the substance of the alleged misrepresentation." The court reversed a lower court's dismissal of a claim under federal securities law, but the underlying principle might well apply in contract cases as well.

See Caiola v. Citibank, NA, 295 F.3d 312, 330 (2d Cir. 2002) (reversing dismissal of claim under federal securities law) (citing cases).

### 13.5.7 Drafting tip: Initial the disclaimer?

If there's a concern that a party might someday try to repudiate its reliance disclaimer, it can't hurt to have that party separately initial the contract as close as possible to the disclaimer, *and be sure the party actually does initial it*.

Otherwise, the drafting party might have an even worse problem: the uninitialed blank line could help persuade a judge or jury that the signing party really did overlook the disclaimer; that's just the opposite of what the drafting party wanted.

And in some circumstances, the law might *require* initialing of a reliance disclaimer.

Example: In a New York case, an estranged married couple reconciled — temporarily, as it turned out. During their reconciliation, the wife voluntarily dismissed her three pending lawsuits against the husband, and they signed a settlement agreement to that effect. But then the couple separated again, and the wife sued the husband again, this time claiming that he had fraudulently induced her to dismiss her other lawsuits by promising that he would return to her and permanently resume their marital relationship.

Unfortuantely for the wife, the settlement agreement she signed included a reliance disclaimer, which she had specifically initialed; as the court acidly noted: "There is no allegation

in the complaint that plaintiff did not read or did not understand the agreement; *in fact, she initialed the agreement in the margin opposite the very paragraph disclaiming the alleged representation*."

> See Cohen v. Cohen, 1 A.D.2d 586 (N.Y. App. Div. 1956) (per curiam; affirming dismissal of complaint for insufficiency).

## 13.6 Pro tips about reps and warranties

### 13.6.1 Drafting goof: Don't use *represents* to commit to future action

Contract drafters shouldn't use the term *represents* to indicate that a party will take or abstain from action — commitments to future action should instead be written as promises (covenants).

> ✘ Alice *represents* that she will pay Bob $1 million.
>
> ✘ Alice *represents and warrants* that she will pay Bob $1 million.
>
> ✓ Alice *will* pay Bob $1 million.
>
> ✘ Alice *represents* that she will not use Bob's confidential information except as stated in this Agreement.
>
> ✓ Alice *will not* use Bob's confidential information except as stated in this Agreement.
>
> (Leave out the italics, usually.)

Why? Consider the "Before" example above: If Alice failed to pay Bob, she might try to claim that she should not be liable for nonpayment because *when she made the representation*, she had no reason to believe that she would not make the payment. A court might treat such a "representation" as a simple promise, but the drafter would do all concerned a disservice by not making the obligation explicit and unconditional.

> > See Lyon Fin. Serv., Inc. v. Illinois Paper & Copier Co., 848 N.W.2d 539 (Minn. 2014) (on certification from 7th Circuit) (holding that "a claim for breach of a contractual representation of future legal compliance is actionable under Minnesota law without proof of reliance").

### 13.6.2 Disclaim *investigation* of representations?

[NONE] explicitly states that a party making a representation is also certifying that the party has a reasonable basis for the representation. This is to try to forestall parties from recklessly making representations about things of which they know not.

This could end up being important; for example, in 2019 a natural-gas provider was hit with a judgment for some $9 million for fraudulent inducement and negligent misrepresentation, because (the court found) the provider had recklessly represented to a customer that the provider had certain capabilities, when the provider "did not do any investigation as to whether [it] could satisfy this obligation …."

> Rainbow Energy Marketing Corp. v. American Midstream (Alabama Intrastate) LLC, No. 17-24591 slip op. ¶ 54 (Harris Cty. Dist. Ct. Jul. 29, 2019) (findings of fact and conclusions of law).

Here's a hypothetical example: Suppose that Alice is selling Bob a used car that she has been keeping in a garage in another city; she wants to *represent*, but not *warrant*, that the car is in good working order. She could phrase her representation in one of two basic ways:

• *Phrasing 1:* Alice says, "I represent that the car is in good working order." Under [NONE], Alice is *implicitly* making an ancillary representation, namely that she has a reasonable basis for her main representation that the car is in good working order, perhaps because she recently drove it or had it checked out by a mechanic.

• *Phrasing 2:* "*So far as I know*, the car is in good working order." By using the phrase *so far as I know*, Alice should be held to have implicitly *disclaimed* any such ancillary representation.

(Alice could make the disclaimer of Phrasing 2 even strongly by saying, for example: "So far as I know, the car is in good working order, *but it's been sitting in the garage for years and I have no idea what kind of shape it's in*.")

**Pro tip:** Some representations use phrasing such as "*to Representing Party's knowledge*, X is true" — this is unwise, in the author's view, because it could be argued to mean that Representing Party is implicitly representing that it does indeed *have* knowledge that X is true. That argument should not prevail, but (to paraphrase a former student) that's a conversation we don't want to have.

### 13.6.3 Warranting a *present* or *future* fact? (It might matter.)

Drafters of representations and warranties should be careful to be clear just what is being represented warranted: Is it a *present* fact, or is it a *future* fact? The distinction can be important because in many jurisdictions:

- The "clock" for the statute of limitations will not start to tick for a warranty of *future performance* (for example, a warranty that a car will not have any mechanical problems for X years or Y miles) until the warranty failure is *discovered*;

- In contrast, for a warranty of *present fact* — for example, that goods *as delivered* are free from defects — the clock starts ticking *at delivery*.

This is illustrated in an Indiana case in which the state's supreme court noted that:

> Under the UCC, a party's cause of action accrues (thus triggering the limitations period) upon delivery of goods.
>
> However, if a warranty explicitly guarantees the quality or performance standards of the goods for a specific future time period, the cause of action accrues when the aggrieved party discovers (or should have discovered) the breach. This is known as the future-performance exception.
>
> Kenworth of Indianapolis, Inc., v. Seventy-Seven Ltd., 134 N.E.3d 370, 374 (Ind. 2019).

In that particular case, said the supreme court, a truck manufacturer's warranty for its vehicles was worded in such a way as to constitute a warranty of future performance; the court said that:

> Courts and commentators generally agree that, in order to constitute a warranty of future performance under UCC section 725(2), the terms of the warranty must unambiguously indicate that the seller is warranting the future performance of the goods for a specific period of time.
>
> *Id.* at 378 (cleaned up).

The court also said:

> [W]e reject the premise that Sellers' duty to repair and replace defective goods alone constitutes a future-performance warranty under the UCC. The promise must explicitly extend to the *goods'* performance, not the *sellers'* performance, for a specific future time period.
>
> *Id.* at 379 (emphasis added).

### 13.6.4 Be careful *what* you warrant

Recall that a warranty is in effect an insurance policy against the occurrence of a future event — *even if the future event is someone else's fault*. In a British Columbia case:

- A supplier sold water pipes to a customer for use in a construction project designed by the customer. The pipes conformed to the customer's specifications — in other words, the supplier delivered what the customer ordered. But *flaws in the customer's design* led to problems.
- The contract's warranty language stated that the *supplier* warranted that the pipes were "free from all defects arising at any time *from faulty design*" (emphasis added).

The trial court ruled in favor of the supplier because the design problem was the customer's fault — but the appeals court reversed, holding that the supplier was liable because of its warranty.

> See Greater Vancouver Water Dist. v. North American Pipe & Steel Ltd., 2012 BCCA 337 (CanLII).

The appeals court said:

> [24] North American was obliged to deliver pipe in accordance with the appellant's specifications. North American agreed to do so.
>
> Quite separately, it warranted and guaranteed *[sic]* that if it so supplied the pipe, it *[sic; the pipe]* would be free of defects arising from faulty design. *These are separate contractual obligations*. The fact that a conflict may arise in practice does not render them any the less so.
>
> The warranty and guarantee provisions reflect a distribution of risk.
>
> * * *
>
> [34] Clauses such as 4.4.4 distribute risk. Sometime they appear to do so unfairly, *but that is a matter for the marketplace, not for the courts*.
>
> There is a danger attached to such clauses. Contractors may refuse to bid or, if they do so, may build in costly contingencies. Those who do not protect themselves from unknown potential risk may pay dearly. …
>
> Parties to construction or supply contracts may find it in their best interests to address more practically the assumption of design risk. To fail do to so merely creates the potential for protracted and costly litigation.

> *Id.* at ¶¶ 24, 32 (emphasis and extra paragraphing added).

### 13.6.5 Is a warranty a guarantee?

Colloquially the terms "warranty" and "guarantee" are alike, but technically there are some differences; see the commentary accompanying [PH].

### 13.6.6 A hypothetical case: Alice and Bob, again

Let's return to our Alice-and-Bob hypothetical to examine the differences between a *representation* and a *warranty*.

#### *13.6.6.1 Alice and Bob (1): Warranty only*

Suppose that Alice only *warranted* a fact, but she did not *represent* it. For example, suppose that Alice sold her car to Bob, and she *suspected*, but didn't know for sure, that the engine was going to need work.

In that case, Alice might:

- warrant, *but not represent*, that the car was in good working order, and

- limit Bob's remedy to Alice's reimbursing Bob for up to, say, $200 in repair costs.

In that situation, at trial Bob would be trying to climb the *right* side of the above Hill of Proof. The only three evidentiary checkpoints that Bob would need to reach, in reaching out with his right hand toward *that* side of the Hill, would be the following:

1. Proof that Alice *warranted* a statement of past or present fact, to use Tina Stark's formulation *[I'll leave out future facts for now]*. Here, Alice's statement is "the car is in good working order";

2. Proof that Alice's statement was false — her car, as delivered to Bob, turned out to need some significant work; and

3. Proof that Bob incurred damages as a result, i.e., repair costs.

If, at the trial, Bob can successfully get past those three evidentiary checkpoints on right side of the Hill of Proof, then he will be entitled to recover warranty damages (generally, benefit-of-the-bargain damages) for Alice's breach of warranty — but in this case, *limited by the contract* to $200 in repair costs.

And that's it; without more, Bob needn't prove that he reasonably relied on Alice's warranty — but neither will he be entitled to tort-like remedies for fraudulent inducement or negligent misrepresentation, such punitive damages and/or rescission, i.e., unwinding the contract, as he would on the left side of the Hill.

#### *13.6.6.2 Alice and Bob (2): Representation and warranty*

But now suppose that Alice both represented *and* warranted the statement of fact, i.e., that her car was in good working order. And then suppose that Bob successfully hits the first three evidentiary checkpoints on the left- and right sides of the Hill of Proof. In that situation, Bob can try to keep going to hit still more checkpoints *on the left side of the Hill*, namely:

4. Proof that Bob in fact relied on Alice's representation — that will probably be almost a given, of course, by virtue of the representation's being expressly set forth in the contract;

5. Proof that Bob's reliance was reasonable — ditto, although Alice could try to prove that Bob's reliance was *not* reasonable under the circumstances; and

6. Proof that Alice *intended* for Bob to rely on Alice's representation — ditto; and

7. Proof that Alice made the false representation intentionally (or possibly, in some jurisdictions, was negligent or reckless in doing so). This is usually the biggie, from a proof perspective.

If Bob can successfully hit all of *these* additional evidentiary checkpoints on the *left side* of the Hill of Proof (and if Alice fails to show that Bob's reliance on her representation was unreasonable), then Bob would be additionally entitled to more "prizes," namely tort-like remedies such as rescission and perhaps punitive damages.

At trial, Bob might well assert both breach of warranty *and* fraudulent inducement or negligent misrepresentation. That way, if Bob proves unable to show scienter on Alice's part, then he can still fall back on his warranty claim.

The same would be true if Alice could persuade the factfinder that Bob's reliance on her (mis)representation was unreasonable: Bob would lose on his claim for fraudulent inducement or negligent misrepresentation would fail, but he might still be able to win on his warranty claim.

#### *13.6.6.3 Alice and Bob (3): Representation only*

Let's change up the hypothetical once more: Suppose that Alice had no reason to think her car had any problems, *but* she also didn't want to bear any risk that it did have problems. In that case, Alice might represent, *but not warrant*, something like the following: "So far as I know, the car is in good working order, but I'm not a mechanic and I haven't had it checked out by a mechanic."

In that situation, if the car did turn out to have problems, then Bob would have to hit *all six* checkpoints *on the left side* of the Hill of Proof to recover damages from Alice; the first three alone, on both the left- and right sides, would not be enough — even though the first three would be enough if Alice had *warranted* the car's good condition.

### 13.6.7 "Which do I want for my client – a rep, or a warranty?"

Here's a rule of thumb:

• A party that is *asked to* represent or warrant something (such as a seller) will always want to consider whether to warrant the thing or to represent it; this might well vary depending on the party's actual knowledge and the potential financial exposure if the represented- or warranted thing turns out not to be true.

• In contrast, any party *asking for* a representation or warranty (such as a buyer) will always want to push for **both** a representation **and** a warranty, so as to give that party more flexibility in litigation — see the two sides of the Hill of Proof in § 13.3 — in case the represented- or warranted thing turns out to be false.

This suggests the following strategy for drafting **with a future trial in mind:**

– If your client is being asked to represent *and* warrant some fact — say, if your client is a supplier being asked for a commitment about its products or services — then consider whether the client should only represent the fact, or whether the client should only *warrant* the fact. As a matter of *negotiation* strategy the client might eventualy end up agreeing to do both, but as a drafter it's worth giving some thought to the question.

– On the other hand, if *your* client is asking *someone else* to represent and warrant a fact — say, if you're a customer asking for a commitment from a supplier — then you'll want to ask for the contract language to include both a representation *and* a warranty. Your client might not have the bargaining power to insist on getting both, but if it does, then having both will give the client more flexibility if litigation should ever come to pass.

Why would a customer ask *for* both a representation and a warranty? Because **"they lied!" is a stinging charge** — and when a big contract fails, trial counsel will pretty much always try hard to find opportunities to accuse the other side of having misrepresented facts. Doing so can work, sometimes spectacularly well: Jurors and even judges might not understand the nuances of the dispute, but they will definitely undertand the accusation that "they lied!"

Bryan Garner points this out in his famed dictionary of legal usage:

> **representations and warranties**. … Some have asked this: if the warranty gives so much more protection than a representation, why not simply use warranty alone—without representation? It's a fair point, perhaps, but here's the reason for sticking to both: some parties to a contract don't want merely a guarantee that so-and-so will be so in the future; they also want an eye-to-eye statement (representation) that the thing is so now. If it later turns out not to have been so when the representation was made, the the party claiming breach can complain of a lie. …
>
> If only a warranty were in place, the breaching party could simply say, "I'll make good on your losses—as I always said I would—but I never told you that such-and such was the case." Hence *representations and warranties*.
>
> Bryan A. Garner, *Representations and warranties*, Garner's Dictionary of Legal Usage (3d ed. 2011) (emphasis edited, extra paragraphing added), *quoted in* Ken Adams, Revisiting "Represents and Warrants": Bryan Garner's View (AdamsDrafting.com 2011).

**Example: Oregon v. Oracle.** We see the above in the civil suit filed by the state of Oregon against Oracle, in which *the second paragraph of the complaint* said, in its entirety (with extra paragraphing added for readability):

> Oracle lied to the State about the "Oracle Solution."
>
> Oracle lied when it said the "Oracle Solution" could meet both of the State's needs with Oracle products that worked "out-of-the-box."
>
> Oracle lied when it said its products were "flexible," "integrated," worked "easily" with other programs, required little customization and could be set

> up quickly.
>
> Oracle lied when it claimed it had "the most comprehensive and secure solution with regards to the total functionality necessary for Oregon."

The state named various Oracle managers and executives, *personally*, as co-defendants in a multi-million lawsuit over a failed software development project, with the state suing one Oracle technical manager for $45 million (!).

> Here's a wild speculation, based on zero evidence: It seems possible that the state sued the individuals personally to try to motivate them to cooperate with the state, akin to when criminal prosecutors bring indictments against all kinds of people to encourage them to cooperate in return for dismissal or a lighter sentence.

The lawsuit was later settled — Oracle agreed to pay Oregon $25 million in cash and provide the state with another $75 million in technology.

**Example: British Sky Broadcasting v. EDS.** British Sky Broadcasting ("Sky") contracted with EDS to develop a customer relationship management (CRM) software system. The project didn't go as planned, and Sky eventually filed suit.

> See BSkyB Ltd. v. HP Enterprise Services UK Ltd., [2010] EWHC 86 (TCC).

- In the (non-jury) trial, the judge concluded that EDS had made fraudulent misrepresentations when *one* of EDS's senior UK executives, wanting very much to get Sky's business, lied to Sky about EDS's analysis of the amount of elapsed time needed to complete the initial delivery and go-live of the system. See id. at ¶ 2331 and ¶¶ 194-196.
- The judge also concluded that during subsequent talks to modify the contract, EDS made additional misstatements that didn't rise to the level of fraud, but still qualified as negligent misrepresentations. See id. at ¶ 2336.
- A limitation-of-liability clause in the EDS-Sky contract capped the potential damage award at £30 million. By its terms, though, *that limitation did not apply to fraudulent misrepresentations*; the judge held that the limitation didn't apply to negligent misrepresentations either. See id. at ¶¶ 372-389.

Arguably one of the most interesting aspect of the judge's opinion is its detailed exposition of the facts, which illustrate how even just one vendor representative can make a deal go terribly wrong for his employer.

In early June 2010, EDS reportedly agreed to pay Sky some US$460 million — *more than four times the value of the original contract* — to settle the case.

> See Jaikumar Vijayan, EDS settles lawsuit over botched CRM project for $460M, Computerworld, June 9, 2010.

### 13.6.8 Insurance for representations & warranties?

If you're being asked — or asking another party — to make representations and warranties, you might want to investigate whether insurance coverage is available for those reps and warranties. (It appears that such insurance might be available primarily for merger- and acquisition ("M&A") deals.)

> See generally, e.g.: • Joseph Verdesca, Paul Ferrillo, and Gabriel Gershowitz, Representations and Warranties Insurance: What Every Buyer and Seller Needs to Know (Weil.com 2016), archived at https://perma.cc/RSU3-66V3; • Eric Jesse, Reps & Warranties Insurance: Five Myths Dispelled (JDSupra.com 2020), archived at https://perma.cc/9FWX-3HSH.

## 13.7 Recap: Key takeaways about reps and warranties

Here are some things every contract drafter and reviewer should know about representations and warranties:

1. A representation is not the same thing as a warranty, at least not in U.S. law. The two terms relate to different categories of fact, and they have different legal ramifications in litigation.

2. A representation is, in essence, a statement of past or present fact.

3. A representation might be paraphrased as: *So far as I know, X is true, but I'm not making any promises about it*.

4. When qualifying a representation as in #3 above, use a term such as, *so far as I know*, and not the term to my knowledge: In a lawsuit, an aggressive trial counsel might claim that the latter term amounts to an implicit representation that the representing party did indeed have knowledge.

5. A representation can include the disclaimer "*without any particular investigation*"; this could be paraphrased as: *I'm not aware that X* isn't *true, but I'm not saying that I've looked into it*.

6. In contrast: The term *warranty* is a shorthand label for a kind of conditional covenant, a strict-liability promise — akin to an insurance policy — that if the warranted fact(s) are shown to be untrue, then the warranting party will make good on any resulting losses suffered by the party to whom the warranty was made. A warranty is a strict-liability obligation that applies even if the warranting party wasn't at fault.

*Example*: Consider the simple warranty, *Alice warrants to Bob that Alice's car will run normally for at least 30 days*. This is tantamount to a promise by Alice that, if Alice's car fails *for any reason* to run normally for at least 30 days, then Alice will pay for repairs, a rent car, and any other foreseeable damages resulting from the failure.

7. A warranty might be paraphrased as: *I'm not going to say that X is or isn't true, but I'll commit that, if it turns out that X isn't true, then I'll reimburse you for any resulting foreseeable losses that you suffer* — or alternatively: *then I'll take the following specific steps, and only those steps, to try to make it right for you*.

8. Representations and warranties can be carefully drafted so as to be narrowly specific.

9. A warranty can be drafted to limit the remedies available if the warranted facts turn out not to be true. (A typical triad of remedies can be summarized as: *repair, replace, or refund*, as discussed in [NONE].)

10. A party that is asked to make both a representation and warranty about particular facts (e.g., a seller of goods being asked to represent and warrant the quality of the goods) should consider whether it really wants to make *both* of those commitments for all the requested facts — that party might want to make only representations as to some facts and only warranties as to other facts.

11. On the other hand, suppose that a services provider and a customer are entering into a contract for services. If the provider will be giving any kind of warranty about its services, the customer should always at least try to get both a representation and a warranty; that will give the customer more flexibility in litigation.

## 13.8 Warranties: A checklist for business planners

Drafters should consider the following issues:

1. What *exact* past, present, or future fact will a party "warrant"?

2. Would the warranting party prefer to make a *representation* about the warranted fact instead of a warranty? See § 13.6.7 for discussion. (BUT: The party that is to benefit from the warranty will *always* prefer that the warranting party do both: Represent, *and* warrant.)

3. Will the warranting party be warranting —

    - a *present* fact (for example, when a seller warrants the condition of goods *as delivered*)?

    - a *future* fact (e.g., when a seller warrants that goods will perform in a certain way for a stated period of time)? This can make a difference for when the statute of limitations begins to run for a claim of breach of warranty, as discussed in Section 13.6.3: .

4. What exactly does the warranting party commit to *do* if a warranted fact turns out not to be true — anything specific, such as the Three Rs? (Repair, Replace, or Refund)?

- If the contract is silent on that point, then the warranting party would liable in damages for any breach of the warranty.

5. Are there any *time* limits to the warranting party's obligation? For example: Warranty issues must be reported to the warranting party within X days after delivery.

6. Are there any *monetary* limits to the warranting party's obligation? For example:

- *Cap:* The warranting party will not be liable for more than $XXX if a warranted fact turns out to be untrue; or
- *Basket:* The warranting party will not be liable for breach of warranty until the resulting damages exceeds $XXX, at which point:
  - *Deductible basket:* The warranting party will be liable only for damages in excess of that amount (known as a "deductible basket"); or
  - *Tipping-* or *first-dollar basket:* The warranting party will be liable for all damages after the specified amount has been reached.basket").

## 13.9 Asset purchases: Where reps and warranties come in

Here's a brief, greatly-simplified overview of how *major* asset purchases generally proceed:

1. The buyer and seller sign a contract that commits each of them to the transaction. (If only one party is committed, it's known as an "option" contract.) The purchase-and-sale contract includes, among other things:

- a specific **identification** of the asset being purchased;
- the **price** and how it is to be paid — in money (currency, check, wire transfer, etc.) and/or assets (e.g., shares of the buyer's stock);
- a **closing date**, with a time and place (often remote), at which the formal exchange is to take place; and
- **representations and warranties** by each party — the seller's reps and warranties typically set forth a "platonic ideal" of what the purchased asset should be (both factually and legally, e.g., ownership

claims), together with a **disclosure schedule** that lists all ways that the purchased asset is acknowledged to differ from that ideal;

- a period for pre-closing **due diligence** during which the buyer gets to "kick the tires" more and confirm that the seller's reps and warranties are accurate;

- a list of **conditions to closing** — these are events (or circumstances) that can allow one or both parties to abandon the deal, such as one or more of the seller's reps and warranties proving to be materially inaccurate;

- a **go / no-go date** by which the buyer has to decide: *Am I going to close the deal, or not?*;

- each party's **obligations** during between signature and closing — e.g., the seller mustn't do anything that would impair the value of the asset.

2. The buyer does due diligence — nearly always, the seller is contractually required to cooperate with the buyer's due diligence (and the buyer can walk away from the deal, and perhaps sue for specific performance and/or damages, if the buyer doesn't cooperate).

3. The parties obtain the required government approvals, if any.

4. At the closing — assuming that neither party has walked away — the agreed consideration changes hands, and ownership is conveyed.

## 13.10 Additional citations

For extensive additional citations in this area, see Professor Tina Stark's scholarly pummeling of the misguided notion that representations and warranties amount to the same thing, which she offered in two comments on Ken Adams's blog.

For an earlier piece on the same subject by Stark, also responding to an Adams essay, see her Nonbinding Opinion: Another view on reps and warranties, *Business Law Today*, January/February 2006.

Some of Adams's earlier pieces espousing the purported synonymity of *representation* and *warranty* can be found at: • A lesson in drafting contracts — What's up with 'representations and warranties'?, The Business Lawyer, Nov./Dec. 2005, as well as • here, here and here.

See also Robert J. Johannes & Thomas A. Simonis, Buyer's Pre-Closing Knowledge of Seller's Breach of Warranty, Wis. Law. (July 2002) (surveying case

law).

An English court decision highlighted the difference between representations and warranties: See Sycamore Bidco Ltd v Breslin & Anor [2012] EWHC 3443 (Ch) (2012), *discussed in, e.g.*: • Raymond L. Sweigart and Christopher D. Gunson, 'Reps' and Warranties: One Could Cost More Than the Other Under English Contract Law (PillsburyLaw.com 2013); and • Glenn D. West, That Pesky Little Thing Called Fraud: An Examination of Buyers' Insistence Upon (and Sellers' Too Ready Acceptance of) Undefined "Fraud Carve-Outs" in Acquisition Agreements, 69 Bus. Lawyer LAW. 1049, 1058 n.47 (2014).

## 13.11 Exercises and discussion questions

### 13.11.1 Exercise: Selling a car

FACTS: Your elderly, childless Uncle Ed is selling his car to a stranger. He says he doesn't know of any mechanical problems.

QUESTION: If the stranger asks Uncle Ed to represent and warrant in writing that the car has no problems, how might he respond as to —

- the requested *representation*?
- the requested *warranty*?

### 13.11.2 Exercise: Buying a car

See Section 13.9: for a brief overview of how asset purchases typically work.

FACTS: Your elderly, childless Uncle Ed now wants to *buy* a car, namely a 1962 Ferrari 250 GTO, for which he'll pay $50 million.

> The same car sold for $48.4 million *[note how this number is written]* at a 2018 Sotheby's auction (link).

EXERCISE: As Uncle Ed's attorney, make a simple list — don't worry about legalese — of the following:

- the representations and/or warranties that you might want — think about things such as:
  - who actually owns the car;
  - whether anyone else has any claims to the car, whether of partial- or outright ownership or of security interests (liens) in the car;
  - what kind of shape the car is in;
  - has the car been in any accidents;

- what if any "due diligence" you might want the seller to allow Uncle Ed to conduct after the contract is signed but before the closing;
- what obligations Uncle Ed would want the seller to comply with between signing and closing — not just "thou *shalt*" obligations but also "thou shalt *not*" obligations as well;
- how the closing will work mechanically, such as:
    - how will money hands;
    - how will Uncle Ed get the keys;
    - how will Uncle Ed get any additional deliverables that he needs to establish or confirm his ownership;
    - what must be done at the closing to satisfy Uncle Ed that "we're done here" (the deal is complete, there's nothing left to do).

# Chapter 14 **Export controls**

The export-controls laws in the U.S. are a bit complicated, but it's extremely important for companies and counsel to get a handle on them.

Here are a couple of examples of "exports" that might be surprising:

- Disclosure of controlled technical data to a foreign national in the U.S. can constitute an "export" that requires either a license or a license exception.
- Emailing controlled technical data to a U.S. citizen located in a foreign country could constitute an export of the data.

Want to do ten years in prison? Just do an "export" of technical data witout the required export license (or license exception). Even without prison, you could be heavily fined and/or denied export privileges.

EXAMPLE: A 71-year old emeritus university professor was sentenced to **four years in prison** for export-controls violations. The professor had been doing research, under an Air Force contract, relating to plasma technology designed to be deployed on the wings of remotely piloted drone aircraft. Apparently, his crime was to use, as part of the project staff, two graduate students who were Iranian and Chinese nationals respectively. (It probably didn't help that the professor was found to have concealed those graduate students' involvement from the government.)

> See Bloomberg.com 2012: https://goo.gl/gfvGhR; FBI.gov 2012: https://goo.gl/jtZR7C.

EXAMPLE: In a related vein, in late 2019 a cryptocurrency expert was arrested for having traveled to North Korea to present at a Pyongyang blockchain and cryptocurrency conference, despite having been warned by the State Department that doing so was prohibited by sanctions legislation.

> See a Department of Justice press release at https://preview.tinyurl.com/v5hhf6r.

For additional information, see, e.g.:

- Overview of U.S. Export Control System (state.gov 2011)
- a "red flags" list published by the Bureau of Industry and Security in the U.S. Department of Commerce (bis.doc.gov 2019)

**Note:** In 2020, the U.S. Government began looking at expanding export-controls restrictions to cover "foundational" technology, commodities, and software.

> See Dechert LLP, Potential Expansion of U.S. Export Controls: "Foundational" Technologies, Commodities and Software (JDSupra 2020); Department of Commerce, Bureau of Industry and Security, Identification and Review of Controls for Certain Foundational Technologies, 85 FR 52934 (Aug. 27, 2020).

## 15 Foreign Corrupt Practices Act

Bribing foreign "officials" can lead to prison time. See generally the 2020 resource guide issued by the Criminal Division of the U.S. Department of Justice and the Enforcement Division of the U.S. Securities and Exchange Commission, at https://www.justice.gov/criminal-fraud/file/1292051/download.

# Chapter 16 Getting to signature quickly

As noted at Section 2.2: , a client will *very* often prefer an "OK" contract — that is, one that can be signed quickly and provides adequate legal protection against reasonably-likely problems — over a contract that *theoretically* maximizes the client's position in every imaginable situation. This chapter discusses some ways of trying to get *sensible* contracts to signature sooner.

Contents:

## 16.1 Balanced terms get signed sooner

If you're doing the drafting, you can help speed things up considerably by being reasonable in what you *offer to* the other side. That's because many busy business people *greatly* prefer to sign contracts that are reasonably balanced.

The author learned this from personal professional experience: I used to be vice president and general counsel of BindView Corporation, a public network-security software company based in Houston, until we were acquired by Symantec Corporation, the global leader in our field. As outside counsel, I'd helped BindView's founders to start the company.

As soon as I went in-house, I had to handle all our negotiations with customers about our standard contract form. **We dramatically speeded up our deal flow** by revising the contract form to proactively provide **balanced legal terms** that our customers typically asked for, *in ways that we knew we could support*.

In addition to helping us get to signature sooner, the (re)balanced contract form indirectly promoted our product in another way: **Customers began to tell me how much they liked our contract**, which validated their decision to do business with us.

I started making notes of customers' favorable comments, and eventually quoted some of the comments (anonymously) on a cover page of our contract form. Here are just a few of those customer comments, which I posted online some years ago; all are from negotiation conference calls except as indicated:

• From an in-house attorney for a multinational health care company: *I told our business people that if your software is as good as your contract, we're getting a great product.*

• From an in-house lawyer at a U.S. hospital chain: *I giggled when I saw the "movie reviews" on your cover sheet. I'd never seen that before — customers saying this was the greatest contract they'd ever seen. But the comments turned out to be true.*

• From a contract specialist at a national wireless-service provider: *I told my boss I want to give your contract to all of our software vendors and tell them it's our standard contract, but I know we can't do that.*

• From an in-house attorney at a global media company: *This is a great contract. Most contracts might as well be written in Greek, but our business guys thought this one was very readable.*

On a couple of occasions, BindView was the *customer*. On each of those occasions, instead of taking time to negotiate the other vendor's contract form, we proposed just using our form, with us as the customer instead of as the vendor; each time, the other vendor quickly agreed.

You might wonder whether BindView ever experienced legal- or business problems from having a balanced contract form. I'll note only that:

- With the CEO's permission, I talked about our balanced-contract philosophy in continuing-legal-education ("CLE") seminars, and even included a copy of our standard form in written seminar materials; and
- In due course we had a successful "exit" when we were approached and acquired by Symantec Corporation, one of the world's largest software companies and the global leader in our field.

To be sure: Some business people just *love* to "win" as much as they can in every contract negotiation, often violating Wheaton's Law ("Don't be a d**k"). If that's you, please consider whether that approach best serves your long-term goals.

### 16.1.1 Trying to play "hardball" will slow things up

Some say it's best to start a contract negotiation by sending the other side your "hardball" or "killer" contract form that's extremely biased toward your side. By doing so (the theory goes):

- you do what's called "anchoring" the other side's expectations, thus increasing the odds that you'll eventually get more of what you want; and
- you create a batch of potential concessions that you don't *really* care about (sometimes known as "the sleeves from my vest") that you can use for horse-trading.

Certainly there are transactions in which it makes at least some sense to do this.

CAUTION: Some people like to play "the art of the deal"; for those folks, it feels just plain good to come out "on top" when negotiating the legal fine points. But don't underestimate the *immediate* price you'll pay for these putative benefits:

- You'll spend more business-staff time.
- You'll spend more in legal expenses.

- You'll incur opportunity costs: As the 'shot clock' runs down at the end of the fiscal quarter, you'll be spending time on legal T&Cs instead of on closing additional business.

So when negotiating a deal, you might want to ask yourself whether "hardball" legal negotiation is really what you want to be spending your time doing.

It might make sense instead to lead off with a balanced contract form that represents a fair, reasonable way of doing business — one that ideally the parties could "just sign it" and get on with their business.

Moreover, hardball contract drafts send the wrong message: Everyone wants reliable business associates, but how does someone know the other side is friendly and trustworthy? On that score, offering a fair and balanced contract can help.

### 16.1.2 Wounded tigers

Even if your client has a lot of bargaining power, you might well be better off *not* trying to use it to overreach against the other party. Research indicates that hardball negotiation often lead to worse *overall* outcomes:

> If people start with a high anchor and concede slowly, use aggressive tactics, express some anger, they end up achieving favorable negotiated deal terms.
>
> But what we're finding — *and this is our central thesis* — is that sometimes by being more assertive, by being more aggressive, you might end up with a better negotiated outcome …
>
> but ultimately, through that process, *create conflict that causes you to end up with worse value overall*.

The above quote is from the transcript (wharton.upenn.edu) of an interview with Wharton professor Maurice Schweitzer and postdoctoral researcher Einav Hart (emphasis, extra paragraphing, and bullets added.

> See also Einav Hart and Maurice E. Schweitzer, Getting Less: When Negotiating Harms Post-Agreement Performance (2017), available at SSRN: https://ssrn.com/abstract=3039256. For some other perspectives on this article, see the Hacker News discussion, at https://news.ycombinator.com/item?id=22209072.)

For example, suppose that you represent a customer company that has a lot of bargaining power. And suppose that your client wants to use that power to force a vendor to make some tough concessions in a contract negotiation.
• Your client's negotiators might well regard those concessions as an entitlement: *We're the customer, we're the big dog; of course we get what we want.*
• But the customer's negotiators should also recall that ultimately, *all contracts have to be performed by people*. And people will almost certainly be influ-

enced, not just by the words of the contract, but by their employer's then-current interests — and by their own personal interests as well.

If the vendor's *people* feel they've been crushed by the customer, they're unlikely to harbor warm and fuzzy feelings for the customer. (This is at least doubly true if the contract later proves to be a train wreck for the vendor — most business people know that being associated with a train wreck is seldom good for anyone's professional reputation.)

In this situation, the vendor's *people* are not likely to be motivated to go out of their way for that customer. They might well be tempted to "work to rule," to use an expression from the labor-relations world — to do just what the contract requires, and no more. That does neither party any favors.

And the reverse can be true when the shoe's on the other foot. Suppose that *the customer* thinks that it's been taken advantage of by a vendor. When it comes time for renewals, or repeat business, or recommendations to other companies, that vendor probably won't have a lot of brownie points with the customer's people.

*Example:* In a Sixth Circuit case, a software customer did a corporate reorganization by, in relevant part, a series of mergers. As a result of the mergers, the named licensee technically became part of a different corporation that was owned by the same parent company; nothing else had change. The software vendor demanded that the customer re-buy the license; when the customer refused, the vendor took the customer to court — and won. After treating its customer that way, what are the odds that the software vendor would *ever* be able to sell *anything* again to that customer — let alone convince the customer to be a reference for the vendor's future sales efforts? Talk about pennywise and pound-foolish ….

> See Cincom Sys., Inc. v. Novelis Corp., 581 F.3d 431 (6th Cir. 2009) (affirming summary judgment in favor of software vendor).

The lesson for contract drafters and negotiators: Even if you've got the power to impose a killer contract on the other side, think twice before you do so. You could be setting up your client to have to deal later with a wounded tiger.

## 16.2 How to kill a deal: Insist on using your contract form

For reasons good and bad, big companies usually want to use their contract forms, not yours. Certainly it's important to offer to draft the contract. And if the big company *reeaally* wants to do a deal with you, then you might get away with insisting on controlling the typewriter.

But bad things can happen, though, if you simply fold your arms and refuse to negotiate the other side's contract paper. Even if the big company's negotiators

grudgingly agree to work from your draft contract, they'll start the negotiation thinking your company is less than cooperative (which isn't good for the business relationship). Then later, when you ask for a substantive concession that's important to you, they may be less willing to go along. And in any case, their agreement to use your contract form, in their minds, will be a concession on their part, meaning that *you* now supposedly owe *them* a concession.

For a vendor lawyer, there's another danger in insisting on using your own contract form: Your client's sales people will blame their lack of progress on you. Sales folks are always having to explain to their bosses why they haven't yet closed Deal X. Your insistence on using your contract form gives them a ready-made excuse: They can tell their boss that you're holding up the deal over (what they think is) some sort of petty legal [nonsense]. Even if that's not the whole story, it's still not the kind of tale you want circulating among your client's business people.

## 16.3 Combat Barbie: Consider using "distractor" terms

Military people learn early that when preparing for inspection, you don't want to make everything perfect. That's because the inspector will keep looking until he (or she) finds *something* — because if the inspector doesn't find anything, *his superior might wonder whether the inspector really did his job*.

The trick is instead to make everything pretty squared away — but then [mess] things up just a little bit. That way, *the inspector will have something to find* and report to his superior and can go away.

Illustrating the point: In an online form, a British lawyer, who had graduated from Sandhurst (the UK equivalent of West Point), told the following story, paraphrased here:

Photo: Pinterest

At Sandhurst as at U.S. military academies, first-year cadets are hounded relentlessly by upper-class cadets. The British lawyer told of a female first-year cadet who did a good job of squaring away her bunk and gear for inspection — but then she carefully placed a "Combat Barbie" doll on her bunk.

Of course the inspectors *immediately* noticed Combat Barbie — and they used up their entire alloted time for that cadet's inspection in "counseling" her about the unmilitary appearance of having a doll on her bunk. That saved the cadet quite a bit of trouble: Otherwise, the inspectors might have left the cadet's bunk, gear, etc., strewn all over the floor, with orders for the cadet to restore the environment as "additional training."

A similar "distractor" psychology can apply in drafting a contract: Be sure to give the other side's reviewer *something* to ask to change, if for no other reason than to give the reviewer something to report to her boss or client.

*But make it a fairly minor point*; otherwise, the reviewer and her client might dismiss you as naïve — and worse, they might start to question whether *your* client was a suitable business partner.

*Example:* If you're a supplier, consider specifying payment terms of net-20 days, and be prepared to agree immediately to net-30 days if asked. But *don't* specify *net-5 days*, which in many situations would risk branding you as unrealistic about "how things are done."

## 16.4 Which to use: *Shall*? *Will*? *Must*?

When representing a *provider* of goods and services, you might want to be very sparing about saying in a contract that the customer "shall" or "must" do this or that.

- An imperious manner might send the wrong signal about whether your client, the provider, will be "a good business partner."
- A softer, more-deferential approach is to say instead, "Customer *will* do" this or that.

On the other hand, if you anticipate trouble from a counterparty, you might *want* to use the term *must*.

## 16.5 Incorporation by reference

Drafting can sometimes be speeded up by incorporating external material by reference. CAUTION: The incorporated material must still be reviewed, because it has the same force and effect as though the incorporated text or other material had been fully set forth in the body of the document itself.

See generally, e.g., Clauses Incorporated by Reference, 48 C.F.R. § 52.252-2.

### 16.5.1 Caution: Incorporated material should be readily available

If an incorporation by reference of external terms is not clear and unmistakable, a court might hold that the external terms are not part of the contract. For example: The Oklahoma supreme court ruled that a form contract for the sale of hardwood flooring, which referenced "Terms of Sale" *but gave no indication where to find them*, did *not* incorporate the external terms. The court held that: "a contract must make clear reference to the extrinsic document to be incorporated, describe it in such terms that its identity and location may be ascertained beyond doubt, and the parties to the agreement had knowledge of and assented to the incorporated provisions. … BuildDirect's attempt at incorporation was nothing more than a vague allusion."

> Walker v. BuildDirect.com Technologies, Inc., 2015 OK 30, 349 P.3d 549, 551, 554 (2015) (on certification from 10th Circuit).

Pro tip: At the very least, provide a Web link — preferably a short, memorable one — where the additional incorporated terms can be found.

### 16.5.2 Attachment "for general reference" might not work

A Nebraska case reinforces the lesson that incorporation-by-reference language must be clear: An architectural-services contract stated that "[t]he Architect's Response to the District's Request for Proposal *is attached* to this Agreement *for general reference purposes* including overviews of projects and services." But the architect firm's response to the RFP *wasn't* attached to the contract — for that matter, the title wasn't even as stated in the contract provision.

Agreeing with the trial court, the state's supreme court held that "[t]he expression 'for general reference purposes,' interesting though it may be, contrasts with a provision, common in contract law, which incorporates another document by reference. … [The contract language] simply does not incorporate [the architect firm's] responses into the contract."

> Facilities Cost Mgmt. Group v. Otoe Cty. Sch. Dist., 291 Neb. 642, 653-54, 868 N.W.2d 67, 71, 75 (2015) (affirming partial summary judgment but reversing and remanding on other issue); *after retrial*, 298 Neb. 777, 906 N.W.2d 1 (2018).

Caution: It's not hard to see how another court might have held that the contract *did* incorporate the architecture firm's guaranteed-maximum-price response. Still, the contract's drafters, who presumably worked for the school district, might have been more clear about their client's intent.

### 16.5.3 But a clear intent to incorporate might suffice

In a 2014 case, the Fifth Circuit held that a supplier's price quotation sufficiently incorporated by reference a standard-terms-and-conditions document published by the European Engineering Industries Association (the "ORGALIME"), which contained an arbitration provision. The supplier's price quotation didn't expressly incorporate the ORGALIME by reference; instead it stated, "Terms

and conditions are *based on* the general conditions stated in the enclosed ORGALIME S2000." (Emphasis added.)

The Fifth Circuit reviewed Texas law on the point, summarizing that "when the reference to the other document is clear and the circumstances indicate that the intent of the parties was incorporation, courts have held that a document may be incorporated, even in the absence of specific language of incorporation." The appeals court concluded that "the district court erred in holding there was no agreement to arbitrate."

> Al Rushaid v. National Oilwell Varco, Inc., 757 F.3d 416, 420-21 (5th Cir. 2014) (reversing denial of motion to compel arbitration) (cleaned up, citations omitted, emphasis added).

### 16.5.4 Caution: A purchase order might implicitly incorporate text

In a California case, a prime contractor issued a purchase order to a subcontractor. The purchase order mentioned, but did not expressly incorporate by reference, a sales quotation that the subcontractor had previously sent to the prime contractor. Further down in the purchase order, though, the P.O. language referred to "the contract documents *described above or otherwise incorporated herein* …." (Emphasis added.)

Applying the *contra proferentem* rule of contract interpretation (without using that Latin phrase) — and therefore construing the quoted term against the prime contractor — the court held that the "described above or *otherwise* incorporated" term had the effect of incorporating the subcontractor's sales quotation by reference into the purchase order.

> See Watson Bowman Acme Corp. v. RGW Construction, Inc., No. F070067, slip op. at 18, 21-22 (Cal. App. Aug. 9, 2016) (affirming, in pertinent part, judgment on jury verdict awarding damages to subcontractor). Oddly, that portion of the court's opinion was not certified for publication; the published version, which omits the discussion summarized above, is at 2 Cal. App. 5th 279, 206 Cal. Rptr. 3d 281, 283 n.* (2016) .

### 16.5.5 Mentioning part of a document might not incorporate it all

Drafters should pay attention to just what portion or portions of another document are being incorporated by reference. That issue made a difference in a Second Circuit case, where:

> … Addendum 5 *[to the contract in question]* refers only to a single specific provision in *[another agreement]* – the non-compete clause. Where, as here, the parties to an agreement choose to cite in the operative contract only a specific portion of another agreement, we apply the well-established rule that a reference by the contracting parties to an extraneous writing for

> a particular purpose makes it part of their agreement only for the purpose specified.

VRG Linhas Aereas S/A v. MatlinPatterson Global Opportunities Partners II L.P., No. 14-3906-cv (2d. Cir. July 1, 2015) (nonprecedential summary order affirming denial of petition to confirm arbitration award) (cleaned up).

### 16.5.6 A party might deny having received referenced documents

In one Eighth Circuit case, a buyer's purchase-order form referred to an external document with additional terms and conditions, and said the document would be provided on request. In a subsequent lawsuit, however, *the seller denied having ever received the additional document*. That led to (what had to have been) an expensive court fight over whether an arbitration provision and an indemnification provision were part of the contract. The case presents a nice illustration of the Battle of the Forms; the Eighth Circuit ruled that the district court should have conducted a bench trial (there having been no jury demand) to make findings of fact about just who had received what contract documents, and therefore just what terms were or were not part of the parties' contract under UCC § 2-207.

See Nebraska Machinery Co. v. Cargotec Solutions, LLC, 762 F.3d 737 (8th Cir. 2014).

**Lesson:** It's understandable that the buyer didn't want the hassle and expense of having to provide a hard copy of its additional terms and conditions form with every purchase order. Merely offering to provide a copy of the form, though, might well have been insufficient to bind the seller to its terms. The buyer could have put itself in a stronger position in court if it had posted the form on its Web site and then included a link to the form in its printed purchase order.

### 16.5.7 Provisions after signatures should be *clearly* incorporated

In a Kentucky case, a for-profit school used a one-page contract. The basic terms and signature blocks were on the front of the page; additional terms and conditions — including an arbitration provision — were on the back of the page, as part of what the state supreme court described as "a sea of plain-type provisions dealing with tuition refunds, curriculum changes, … and *arbitration*." (Emphasis in original.) Citing a state statute requiring signatures to be at the end of an agreement, the supreme court said that the arbitration clause was not part of the school's agreement.

Dixon v. Daymar Colleges Group, LLC, 483 S.W.3d 332, 345-46 (Ky. 2015) (affirming denial of motion to compel arbitration).

### 16.5.8 Incorporation fits with an entire-agreement clause

The Seventh Circuit rejected an argument that incorporation by reference negated a contract's entire-agreement clause.

> See Druckzentrum Harry Jung GmbH & Co. v. Motorola Mobility LLC, 774 F.3d 410, 416 (7th Cir. 2014) (affirming take-nothing summary judgment in favor of Motorola on Druckzentrum's claims for breach of contract and fraud).

### 16.6 Exercises and discussion questions

# 17 Limitations of liability

Limitation-of-liability provisions usually rank at or near the top of the annual surveys done by World Commerce & Contracting (formerly the International Association for Contract and Commercial Management), a global nonprofit trade association, concerning the most-frequently-negotiated contract terms. Ironically, the same surveys indicate that contract professionals fervently wish they could spend their time negotiating *collaborative* provisions, to try to keep trouble from happening, instead of *liability* provisions, for when trouble does come to pass.

> See Most Negotiated Terms Report - 2020 (WorldCC.com).

The root of the complaint is often the generic one-size-fits-all limitation of liability clause. It's true that negotiators do sometimes debate whether particular types of damage (e.g., damages covered by an indemnity obligation) should be carved out entirely from the damages cap. But that's a false dichotomy; it assumes, for no reason, that a given type of damages will be either subject to the 'default' cap, or not subject to any cap at all.

This section offers suggestions to help parties come to a reasonable compromise about limitations of liability.

### 17.1 Try risk-by-risk limitations of liability

Contract drafters can often speed up discussions of liability limitations by breaking up generic boilerplate language into more-concrete statements of risks that are of particular concern, which the parties can focus on more readily.

One technique that works well is to list specific categories of risk and, for each category, state what if any liability limits are agreed. The categories of risk could include, for example, the following:

- Personal injury
- Tangible damage to property (not including erasure, corruption, etc., of information stored in tangible media where the media are not otherwise damaged)
- Erasure, corruption, etc., of stored information that could have been avoided or mitigated by reasonable back-ups
- Other erasure, corruption, etc., of stored information
- Lost profits from any of the above
- Lost revenue from any of the above
- Indemnity obligations
- Infringement of another party's IP rights (including without limitation rights in confidential information)
- Willful, tortious destruction of property (including without limitation intentional and wrongful erasure or corruption of computer programs or -data)

To be sure, if the non-drafting party won't care much about the limitation of liability anyway, then including such detailed limitation language could actually hinder the overall negotiations.

But remember, by hypothesis we're talking about contract negotiations in which the limitation language is indeed going to be carefully negotiated — in which case this kind of systematic approach will almost always make sense.

## 17.2 Negotiate *variable* limitations of liability?

Exclusions of consequential damages (see [NONE]) and damage-cap amounts (see [NONE]) don't necessarily have to be carved in stone for all time. The parties could easily agree to vary them, either as time passed or as circumstances changed.

*Example:* Suppose that: • A software vendor is negotiating an enterprise license agreement with a new customer for a mature software package. • The customer has successfully completed a pilot project, but it hasn't rolled out the software for enterprise-wide production use. • Knowing how tricky a production roll-out can sometimes be, the customer is concerned about the vendor's insistence on excluding all 'consequential' damages, whatever that really means.

> See the commentary to Tango Clause 22.35 - Consequential Damages Exclusion for a review of the difficulty of determining what constitutes "*consequential* damages."

Our vendor might try offering to waive the consequential-damages exclusion during, say, the customer's first three months of production use of the soft-

ware, *subject to* an agreed dollar cap on the vendor's aggregate liability for all damages — which might be a higher dollar amount than at other times, as discussed below. This approach could make the customer more comfortable that the vendor is 'standing behind its software' during the roll-out phase.

In theory, certainly, the vendor would be exposed to additional liability risk during those first three months. But the business risk might be eminently worth taking. Remember, we're assuming that the software is mature, that is, most of its significant bugs have already been corrected. This means that the vendor might be willing to take on the additional theoretical risk — which in any case would go away after three months — in order to help close the sale.

*Example:* As another illustration, perhaps such a vendor could agree that the damages cap would be, say: 4X for any damages that arise during, say, the first three months of the relationship, or possibly until a stated milestone has been achieved; 3X during the nine months thereafter; and 2X thereafter.

In the 4X / 3X / 2X language, X could be defined: • as a stated fixed sum; • as the amount of the customer's aggregate spend under the contract in the past 12 months, 18 months, etc.; • in any other convenient way.

The details in the above examples aren't important. The point is that sometimes 'standard' limitation-of-liability language is too broad to allow the parties to specify what they really need. Negotiators might have more success if they drilled down into the language.

### 17.3 Discussion questions: Limitations of liability

a. QUESTION: What *could* happen in *some* jurisdictions if an *exclusive* remedy were to "fail of its essential purpose"?

b. QUESTION: What are some common limitations of liability that are seen in contracts?

## 18 Exclusive remedies

### 18.1 Defect correction can be an "exclusive remedy" ...

Under section 2-719 of the [U.S.] Uniform Commercial Code, a contract for the sale of goods can specify that a remedy is exclusive (but there are restrictions and exceptions to that general rule).

A real-world example of this supplier approach was the *BAE v. SpaceKey* case:

- A supplier delivered lower-quality integrated circuits ("ICs") to a customer than had been called for by their contract. The supplier had previously alerted the customer in advance that the ICs in question would not conform to the agreed specifications; the customer accepted the ICs anyway. (The customer later asserted that it assumed the supplier would reduce the price.)
- The customer refused to pay for the nonconforming ICs.
- The supplier terminated the contract and sued for the money due to it.
- The customer counterclaimed — *but it did not first invoke any of the contract's specified remedies*, namely repair, replace, or *credit* (as opposed to refund).

For that reason, the trial court granted, and the appellate court affirmed, summary judgment in favor of the supplier. See BAE Sys. Information & Electr. Sys. Integration, Inc. v. SpaceKey Components, Inc., 752 F.3d 72 (1st Cir. 2014).

## 18.2 But *failure* of "exclusive" remedies might blow the doors open

Providing the right to a refund as a fail-safe "backup" remedy might be crucial in case other agreed remedies fail. Consider that UCC § 2-719(2) provides: "Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act."

(True, UCC article 2 applies only to the sale of goods, of course, but courts have sometimes looked to article 2 for guidance in non-goods cases.)

In other words, if providing a correction or workaround for a defect is the customer's *exclusive* remedy, *but the provider is unable to make good on doing so*, then in some jurisdictions **all limitations of liability might be out the window**, including for example an exclusion of consequential damages or a cap on damages.

Photo: U.S. Dept. of Interior - Bureau of Reclamation.0

See, e.g., John F. Zabriskie, Martin J. Bishop, and Bryan M. Westhoff, Protecting Consequential Damages Waivers In Software License Agreements (2008).

For a now-dated student note reviewing case law in this area, see Daniel C. Hagen, Sections 2-719(2) & 2-719(3) of the Uniform Commercial Code: the Limited Warranty Package & Consequential Damages, 31 Val. U. L. Rev. 111, 116-18 (1996).

# Chapter 19 **Business planning**

*[Note to the author's* law *students: You can just skim this chapter; you won't be tested on it, but you might find it useful.]*

## 19.1 **Introduction**

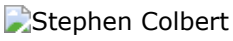
*If you don't know where you're going, you might not get there*. – Yogi Berra.

*Be Prepared*. – Boy Scout motto.

*Plans are worthless; planning is everything*. – Dwight D. Eisenhower.

*[N]o plan of operations extends with any certainty beyond the first contact with the main hostile force*. – Helmuth von Moltke the Elder (often paraphrased as "no plan survives first contact with the enemy").

### 19.1.1 Stephen Colbert proves the benefits of thinking ahead


Stephen Colbert

Stephen Colbert and his agent showed that there's more to contract drafting than just putting words on the page: They planned ahead, setting up Colbert's contracts with Comedy Central so that the contracts would expire at the same time as David Letterman's contracts with CBS. That way, if Letterman ever decided to retire, Colbert would be able to leave the Comedy Central show that made him famous, *The Colbert Report*, and throw his hat in the ring to take over Letterman's *The Late Show* on CBS. See Bill Carter, Colbert Will Host 'Late Show,' Playing Himself for a Change, New York Times, Apr. 11, 2014, at A1.

This worked out well for both Colbert and CBS — in 2019, they agreed to a three-year contract extension through 2023; a New York Times article commented that "The move was a no-brainer for CBS. Mr. Colbert is, by far, the most-watched late-night host." John Koblin, Stephen Colbert Signs a New 'Late Show' Deal Through 2023 (NYTimes.com Oct. 17, 2019).

### 19.1.2 Danger: Hope is not a plan

Wishful thinking can be dangerous, but some people are prone to it — including business people. Contract negotiators should keep this in mind in brainstorming scenarios and action plans.

*Example: Where will the money come from?* When drafting a critical contract obligation for the other side — for example, an indemnity obligation — consider

imposing additional requirements to be sure that there's money *somewhere* to fund the obligation, such as:

- an insurance policy;
- a third-party guaranty;
- a letter of credit from a bank or other financial institution;
- or even taking a security interest in collateral that could be seized and sold to raise funds.

Apropos of wishful thinking, there's an old joke about economists that seems to have been first published in 1970:

- A physicist, a chemist, and an economist are shipwrecked on a desert island with nothing to eat.
- A pallet full of cans of food washes up on the beach, but the castaways have no tools with which to open the food cans.
- The physicist and the chemist each propose ingenious but complicated mechanisms to open the cans, using the materials at hand.
- The economist has a simpler solution: "We'll assume we have a can opener."

> See Wikipedia, Assume a can opener, *quoting* Kenneth E. Boulding, Economics as a Science at 101 (McGraw-Hill 1970).

### 19.1.3 Example: Tesla's supply-chain issues

Here are some dangers that a company can encounter: (1) Not getting paid; (2) not being able to build your product because your suppliers won't supply you with parts unless you pay cash on delivery (C.O.D.); (3) having a supplier go out of business because you didn't pay them. From a Bloomberg story:

> … [A short-seller of Tesla stock] said her firm sees some suppliers to Tesla filing for bankruptcy, which poses particular risk to the carmaker because many of its components are single-sourced. * * *
>
> The Wall Street Journal reported in August on an Original Equipment Suppliers Association survey of executives that found most respondents believed Tesla posed a financial risk to their companies. Some small suppliers claimed in the previous several months that they failed to get paid, the newspaper reported, citing public records.

> Gabrielle Coppola, Tesla Short Seller Warns of 'Massive' Supply-Chain Disruption, Bloomberg.com, Oct. 19, 2018.

## 19.2 "Hey, you: Learn the business!" OK, fine — *but how*?

One of the big complaints clients have about lawyers is that "they just don't understand the business." But it's singularly unhelpful to just say to a lawyer: *Hey, you: Learn the business!* The beneficiary of such advice might not know what to *do* to make that happen.

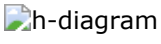
Neither is it particularly useful to add, *Just ask questions!* It might not be obvious what questions should be asked.

So, this chapter presents a series of questions, with handy mnemonic acronyms, to help contract professionals and their clients:

- *identify threats and opportunities* that might need to be addressed in a contract;
- *develop action plans* to prepare for and respond to those threats and opportunities; and
- *flesh out the details* of the desired actions;

all with the goal of drafting practical contract clauses.

## 19.3 T O P S P I N: Identifying threats and opportunities




The acronym T O P S P I N can help planners to identify threats and opportunities of potential interest. (The acronym is inspired by the business concept of SWOT analysis, standing for Strengths, Weaknesses, Opportunities, and Threats.)

The first part of the acronym, T O P, refers to the **threats** and **opportunities** that can arise in the course of the different **phases** of the parties' business relationship. (Those phases can themselves be remembered with the acronym S N O T S: Startup; Normal Operations; Trouble; and Shutdown.)

The second part of the acronym, S P I N, reminds us that various threats and opportunities can be presented by one or more of the following:

• S: The participants in the respective **supply chains** in which the contracting parties participate, both as suppliers and as customers, direct and indirect. If the parties are "Alice" and "Bob," then we can think of Alice's and Bob's respective supply chains as forming a capital letter H, as illustrated below:

• P: The individual **people** involved in the supply chains — all of whom have their own personal motivations and interests;

• I: **Interveners** such as competitors; alliance partners; unions; governmental actors such as elected officials, regulators, taxing authorities, and law enforcement; the press; and acquirers. Don't forget the *individual people* associated with an intervener, all of whom will have personal desires, motives, and interests;

> Political issues can raise their heads; for example, in 2019, convention organizers attracted attention for inserting "morals clauses" into their contracts: "Organizations will not bring events to Texas if *[anti-LGBTQ]* discriminatory bills become law, and *most convention contracts allow organizers to cancel if such laws take effect*." Chris Tomlinson, Bigot bills would damage Texas economy, Houston Chronicle, April 3, 2019, page B1, at B7 col. 2 (emphasis added).

• N: **Nature**, which can cause all kinds of threats and opportunities to arise in a contract relationship.

ICE-CREAM EXAMPLE: Mother Nature might create a threat — and an opportunity for competitors — if an ice-cream manufacturer's products were to become contaminated with listeria bacteria (as happened in 2015 to famed Texas dairy Blue Bell).

> See the U.S. Department of Justice press release, Blue Bell Creameries Agrees to Plead Guilty and Pay $19.35 Million for Ice Cream Listeria Contamination – Former Company President Charged (May 2020).

## 19.4 I N D I A T I L T: Deciding on responsive actions

Once planners have compiled a list of threats and opportunities of interest, they should think about the specific actions that might be desirable — or perhaps specific actions to be prohibited — when a particular threat or opportunity *appears* to be arising. Many such actions will fall into the following categories:

• I: **Information** to gather about the situation in question;

• N: **Notification** of others that the threat or opportunity is (or might be) arising. Refer to the SPIN part of the TOP SPIN acronym above for suggestions about players who might be appropriate to notify.

• D: **Diagnosis**, i.e., confirmation that the particular threat or opportunity is real, as opposed to being an example of some other phenomenon (or just a false alarm).

• I: **Immediate** *action,* e.g., to mitigate the threat or to seize the opportunity.

• A: **Additional** *actions*, e.g., to remediate adverse effects or take advantage of the opportunity.

ICE-CREAM EXAMPLE: Consumers have been known to become ill, and a few have died, after eating ice cream that, during manufacturing, became contaminated with listeria bacteria. The grocery store's planners might want to use the I N D I A checklist to specify in some detail how the ice-cream manufacturer is to respond to such reports, with requirements for notifying the grocery store; product recalls; and so on.

Some plans are likely to require advance preparation. Planners can use the T I L T part of the acronym to decide whether any of the following might be appropriate:

• T: Acquisition of **tools** — such as equipment, information, consumables, etc. — for responding to the threat or opportunity.

• I: Acquisition of **insurance** (or other backup sources of funding).

• L: Posting of a **lookout**, that is, putting in place a monitoring system to detect the threat or opportunity in question.

• T: **Training** of the people and organizations who might be called on to respond to the threat or opportunity.

## 19.5 W H A L E R analysis: Fleshing out the action plans

In specifying actions to be taken, planners will often want to go into more detail than just the traditional 5W + H acronym (standing for Who, What, When, Where, Why, and How). Planners can do this using the acronym W H A L E R:

• W: **Who** is to take (or might take, or must not take) the action.

• H: **How** the action is to be taken, e.g., in accordance with a specified industry standard.

• A: **Autonomy** of the actor in deciding whether to take or not take the action. Depending on the circumstances, this might be:

- No autonomy: The action in question is either mandatory or prohibited, with nothing in between.
- Total autonomy: For the action in question, the specified actor has sole and unfettered discretion as to whether to take the action.
- Partial autonomy: The decision to take (or not take) the action must meet one or more requirements such as:
    - Reasonableness — be careful: that can be complicated and expensive to litigate;
    - Good faith — ditto;

- Notification of some other player, before the fact and/or after the fact;
- Consultation with some other player before the fact; or
- Consent of some other player (but is consent not to be unreasonably withheld? A claim of unreasonable withholding of consent could itself be one more thing to litigate.)

• L: **Limitations** on the action — for example, minimums or maximums as to one or more of time; place; manner; money; and people.

• E: **Economics** of the action, such as required payment actions (each of which can get its own W H A L E R analysis), and backup funding sources.

• R: **Recordkeeping** concerning the action in question (with its own W H A L E R analysis).

## 19.6 The "bow tie method": A diagrammatic approach

A more-complicated approach to identifying and planning for risks is the so-called "bow tie" method, developed by oil-and-gas giant Shell and later adopted in other industries.

> See, e.g., the detailed explanation (with examples) in Julian Talbot, Risk BowTie Method (JulianTalbot.com 2020), archived at https://perma.cc/ATN7-FGAU; see also the Hacker News discussion at https://news.ycombinator.com/item?id=24130809.

The bowtie method of diagramming risks and consequences is reminiscent of Feynman diagrams in the world of physics.

> See generally, e.g., Frank Wilczek, How Feynman Diagrams Almost Saved Space (QuantaMagazine.org 2016). (Wilczek is a Nobel Prize-winning physicist and MacArthur Foundation "genius grant" recipient who was a colleague of Richard Feynman.)

## 19.7 Finally, ask the investigator's all-round favorite question

When I was a baby lawyer at Arnold, White & Durkee, I worked a lot with partner Mike Sutton. One of the many things Mike taught me was that when interviewing or deposing a witness, a useful, all-purpose question consists of just two words: **Anything else?**

That same question can likewise help contract planners get some comfort that they've covered the possibilities that should be addressed in a draft agreement.

## 19.8 Term sheet drafting tips

Here are some basic tips for drafting a term sheet to accompany a Tango email agreement.

- Short sentences are best.
- One (short) sentence per paragraph is best.
- Be very clear *who* is responsible for doing *what*, *when*. As the business cliché puts it: *Whose throat gets choked?*
- Specify any relevant time frames such as:
    - deadlines;
    - earliest- and latest start dates; and/or
    - maximum- or minimum time periods.
- Fences: Spell out any relevant restrictions or limitations. For example: If payments must be made by wire transfer, then say so.
- If a party is or will be relying on information provided by another party, then say so.
- Bullet points are fine as long as they're clear.
- Hypothetical examples can be really useful to illustrate points and educate future readers, such as:
    - business people who need to get up to speed;
    - judges and jurors.
- Diagrams? Tables? Flow charts? Footnotes? Why not — when in doubt, *serve the reader*.

# Chapter 20 Most-favored customer

## 20.1 Examples of most favored customer language

Section 12 of a Honeywell purchase order terms-and-conditions document, archived at https://perma.cc/CUV6-NKTY, sets forth a fairly-typical most-favored-customer clause ("MFC") clause and price-reduction clause ("PRC").

# Chapter 22 The Tango Terms

*A work in progress:* This playbook is still a work in progress; I'm "freezing" this draft for the semester so that students can print it out if they wish.

*Printing:* For many students, this playbook will work just fine if read on the screen. By student request, however, I've tried to set up the playbook for printing to hard copy. Typographically, the setup is less than optimal for printing — for example, there are some page breaks immediately after a heading, instead of keeping the heading together on the same page with the following

text. *(It's not* supposed *to do that, but I haven't figured out why it does, nor how to fix it.)*

## Clause 22.1 Acknowledgement Effect

IF: The Contract includes language in which a party *acknowledges* something; THEN: The acknowledging party WAIVES (see the definition in Clause 22.162):

1. any right to contest the truth of the thing being acknowledged; and

2. any right to require another party to the Contract to prove the acknowledged thing.

Commentary

This definition concerns about acknowledgements made within the body of a contract, as discussed in the commentary at [BROKEN LINK: ack-cmt][BROKEN LINK: ack-cmt][BROKEN LINK: ack-cmt].

For acknowledgements in notary-public certificates, see the reading at Section 3.12: .

## Clause 22.2 Affiliate Definition

### 22.2.1 Control relationship

a. For purposes of the Contract, two persons A and B are "*affiliates*" (or "*affiliated*") if one or more of the following things is true:

1. B "controls" A, as defined in this Definition,

2. or A controls B,

3. or B and A are each under common control of a third person,

4. or the Contract clearly identifies A and B as being affiliates.

b. For this purpose, *control* can be direct, or it can be indirect through one or more intermediaries.

*Example:* If A controls B, and B controls C, then A controls C indirectly.

*Commentary*

*22.2.1.1 Business purpose for defining affiliate*

In some cases, the Contract might give rights to "affiliates" of one or another party, for example the right to acquire goods or services on the same terms as in the Contract. In such a case, it could be important to define just who qualifies as an affiliate of the relevant party. For example:

- A software license agreement might grant the right to use the software not only to the named licensee company, but also to "affiliates" of the licensee company. Such an agreement will almost certainly impose corresponding obligations on any affiliate that exercises the right to use the software.
- A customer might want its "affiliated" companies to be allowed to take advantage of the contract terms that the customer negotiates with a supplier. (The supplier, though, might not be enthused about an expansive definition of *affiliate*: The supplier will often want to be free to negotiate more-favorable terms with the customer's affiliates.)

*22.2.1.2 Language origins*

This basic definition is largely adapted from (a portion of) the definition promulgated by the U.S. Securities and Exchange Commission ("SEC") in Rule 405; substantially-similar language can be found in other sources, notably Black's Law Dictionary.

See Rule 405, 17 C.F.R. § 230.405; see also, e.g., Securus Technologies Inc. v. Global Tel*Link Corp., 676 Fed. Appx. 996 (Fed. Cir. 2017) (quoting Black's Law Dictionary and citing Texas law recognizing the dictionary's authority); McLane Foodservice, Inc. v. Table Rock Restaurants, LLC, 736 F.3d 375, 379 & n.3 (5th Cir. 2013) (same); UBS Securities LLC v. Red Zone LLC, 77 A.D.3d 575, 578 (N.Y. App. Div. 1st Dept. 2010) (quoting Black's Law Dictionary and citing NY and Del. statutes).

The definition provides parties with two separate "proof paths" for establishing affiliate status:

- By showing a direct- or indirect control relationship between two persons (including common control by a third person); or

- By specifically agreeing that two named persons (each, an individual or organizations) are *affiliates* for purposes of the Contract, regardless whether a control relationship exists between them. If it's not possible to determine in advance who all the named affiliate groups will be, the parties could consider:
  - letting one party unilaterally name additional affiliates with the other party's consent, not to be unreasonably withheld; and/or
  - designating specific "open enrollment" periods in which affiliates can be named.

#### *22.2.1.3 Pro tip: Plan for changes in affiliate status*

Contract drafters and reviewers should plan for changes in affiliate status, in case one or more of the following things happens:

- A party acquires a new affiliate, e.g., because its parent company makes an acquisition;
- Two companies cease to be affiliates of one another, e.g., because one of them is sold off or taken private;
- A third party – perhaps an unwanted competitor – becomes an affiliate of "the other side."

#### *22.2.1.4 The timing of affiliate status can be important*

In some circumstances, affiliate status might exist at some times and not exist at others. That could be material to a dispute. Compare, for example:

• New York's highest court held that: "Absent explicit language demonstrating the parties' intent to bind future affiliates of the contracting parties, the term 'affiliate' includes only those affiliates in existence at the time that the contract was executed."

> See Ellington v. EMI Music Inc., 24 N.Y.3d 239, 246, 21 N.E.3d 1000, 997 N.Y.S.2d 339, 2014 NY Slip Op 07197 (affirming dismissal of complaint).

• The First Circuit held that Cellexis had breached a settlement agreement not to sue GTE or its affiliates when it sued a company that, at the time of the settlement agreement, had not been a GTE affiliate, but that later became an affiliate. Reversing a summary judgment, the appeals court reasoned that when read as a whole, the contract language clearly contemplated that *future* affiliates would also be shielded by the covenant not to sue.

> See GTE Wireless, Inc. v. Cellexis Intern., Inc., 341 F.3d 1, 5 (1st Cir. 2003).

### 22.2.2 Voting power for control

If B is a corporation or other organization, then A is considered to control B if A has the power to vote more than 50% of the voting power entitled to vote for members of:

1. the organization's board of directors, or
2. the equivalent body in a non-corporate organization.

*Commentary*

#### *22.2.2.1 Where to set the voting percentage*

A minimum voting percentage of 50% seems to be pretty typical. Drafters, though, should think about why they're defining the term *affiliate*, because the answer might warrant changing the percentage — and it doesn't necessarily have to be the same percentage for every situation or condition. [TO DO: Examples]

#### *22.2.2.2 Voting power can arise by contract*

A voting trust or voting agreement might give Shareholder A the power to vote Shareholder B's shares, even though Shareholder B retains ownership of the shares (for example, to be paid dividends for the shares). See generally, e.g.,

- The Delaware statute concerning voting trusts and voting agreements; and

  See 8 Del. Code § 218.

- The 1996 voting agreement between Jeff Bezos and the Series A investors in Amazon.com.

#### *22.2.2.3 Other possible approaches to voting control*

Some drafters might want voting control also to arise from one or more of the following:

- a legally-enforceable right to select a majority of the members of the organization's board of directors or other body having comparable authority — note that this alternative does **not** say that control exists merely because a person has a **veto** over the selection of a majority of the members of the organization's board;
- a legally-enforceable right, held by a specific class of shares or of comparable voting interests in the organization, to approve a particular type of decision by the organization; or
- a legally-enforceable requirement that a relevant type of transaction or decision, by the organization, must be approved by a vote of a supermajority of the organization's board of directors, shareholders, outstanding shares, members, etc. (The required supermajority might be two-thirds, or three-fourths, or 80%, etc.)

### 22.2.3 Affiliate ≠ party to the Contract

IF: The Contract identifies a party to the Contract as (for example) "ABC Corporation *and its affiliates*" (emphasis added);

THEN: That means only that the (specified) affiliates of ABC Corporation are entitled to certain benefits — possibly accompanied by obligations — but not that the affiliates are partiies to the Contract.

*Commentary*

#### *22.2.3.1 Business context*

Some agreements, in identifying the parties to the agreement on the front page, state that the parties are, say, "*ABC Corporation and its Affiliates*." In the author's view, that's a bad idea unless each such affiliate actually signs the agreement as a party and therefore commits, on its own, to the relevant contractual obligations.

**The much-better practice is to state the specific rights and obligations that affiliates have under the contract**. This is sometimes done in "master" agreements in which, for example, affiliates of a buyer can place orders on the same terms.

#### *22.2.3.2 Caution: Affiliates could be implicitly bound*

An affiliate of a contracting party might be bound by the contract if:

- the contracting party — or its signatory — controls the affiliate, and
- the contract states that the contract is to benefit the affiliate.

That was the result in one case where: (i) the contract stated that it was creating a strategic alliance for the contracting party and its affiliates, and (ii) the contract was signed by the president of the contracting party, who was also the sole managing member of the affiliate. The court held that the affiliate was bound by, and violated, certain restrictions in the contract.

See Medicalgorithmics S.A. v. AMI Monitoring, Inc., No. 10948-CB, slip op. at 3, 52-53, 2016 WL 4401038 (Del. Ch. Aug. 18, 2016). See also Mark Anderson, Don't Make Affiliates parties to the agreement (2014); Ken Adams, Having a Parent Company Enter Into a Contract "On Behalf" of an Affiliate (2008).

### 22.2.4 Control *by management power* must be by contract

a. Party A is also considered to control Party B if a legally-enforceable contract unambiguously gives A the power to direct B's relevant management and policies.

b. A statement in the Contract that affiliate status can arise through "management power" (or comparable terminology) is to be interpreted and applied in accordance with the standard stated in subdivision a.

*Commentary*

This Definition does *not* subscribe to the notion that affiliate status can arise through *non-contractual* forms of management power, even though that concept can be found in U.S. securities regulations.

See, e.g., SEC Rule 405, 17 C.F.R. § 230.405.

That's because the vagueness of the quoted term could lead to expensive litigation. See, for example:

- A Fifth Circuit case in which the parties had to litigate who had had "control" of a vessel destroyed by fire, and thus which party or parties should be liable for damages;

  See Offshore Drilling Co. v. Gulf Copper & Mfg. Corp., 604 F.3d 221 (5th Cir. 2010).

- A New York case in which the parties litigated whether a global financial-services firm was entitled to a $10 million fee for a corporate acquisition deal — and in the aftermath, a blue-chip NYC law firm was hit with a $17.2 million malpractice judgment for not nailing down an agreed definition of *control* to govern when the deal fee would be earned.

  See UBS Securities LLC v. Red Zone LLC, 77 A.D.3d 575, 578, 910 N.Y.S.2d 55 (N.Y. App. Div. 1st Dept. 2010). Concerning the malpractice award, see Red Zone LLC v. Cadwalader, Wickersham & Taft LLP, 45 Misc.3d 672, 994 N.Y.S.2d 764 (N.Y. Sup. Ct. 2013), *aff'd*, 2014 NY Slip Op 4570, 118 A.D.3d 581 988 N.Y.S.2d 588 (App. Div. 1st Dept. 2014).

## Clause 22.3 Agreement-Related Dispute Definition

The term "*Agreement-Related Dispute*" refers to any claim, controversy, or other dispute between the parties — whether based on the law of contract; tort; strict liability; statute; or otherwise — that (i) is brought

before any tribunal (see the definition in Clause 22.159); and (ii) is based upon, arises out of, or relates to any of the following:

1. the Contract;

2. a document executed in conjunction with the Contract;

3. a transaction or relationship memorialized by, or resulting from, the Contract (each, a "*Transaction*" or "*Relationship*," respectively);

4. a service provided pursuant to, or incidentally to, the Contract or a Transaction or Relationship;

5. insurance for, or relating to, the Contract or a Transaction or Relationship;

6. a document that documents or otherwise contains information about any of the items listed in subdivisions 2 through 5;

7. an application for, or an advertisement, solicitation, processing, closing, or servicing of, a Transaction or Relationship; and

8. any representation or warranty that is made:

   in, or in connection with, any document listed in subdivisions 1, 2, 6, and/or 7; and/or

   to induce anyone to enter into, agree to, or accept any such document.

*Commentary*

This "laundry list" borrows concepts from the second of two arbitration agreements in a lawsuit; some of the language is adapted from a suggestion by a noted corporate practitioner.

> See Porter Capital Corp. v. Roberts, 101 So. 1209, 1218-19 (Ala. App. 2012) (affirming denial of plaintiffs' motions to compel arbitration of defendant's counterclaims); Glenn D. West & W. Benton Lewis, Jr., Contracting to Avoid Extra-Contractual Liability — Can Your Contractual Deal Ever Really Be the "Entire" Deal?, 64 Bus. Lawyer 999, 1036, text accompanying n.232.

Subdivision 3: the *transaction or relationship …* term is modeled on an arbitration provision that has been litigated at least twice.

> See Sherer v. Green Tree Servicing LLC, 548 F.3d 379, 382-83 (5th Cir. 2008), *citing* Blinco v. Green Tree Servicing LLC, 400 F.3d 1308, 1310 (11th Cir. 2005).

Subdivision 8: The inducement reference has in mind claims of fraudulent inducement; it borrows from model language by another noted corporate practitioner.

> See Byron F. Egan, Forum-Selection, Jury-Waiver, and Choice-of-Law Provisions in Acquisition Agreements (2018), https://perma.cc/3G4L-UVZB), at part V, text accompanying note 105.

## Clause 22.4 Amendments

### 22.4.1 Writing requirement for amendments

a. To be effective, a purported amendment to the Contract (or any related document):

1. must be in writing; and

2. must be clearly labeled as an amendment.

b. The labeling must be reasonably prominent, for example (without limitation) by including the word "Amendment" as part of the title of the amending document,

so that a party that is presented with such a writing will have fair notice about its intended effect.

*Commentary*

*22.4.1.1 Purpose*

Amendments-in-writing requirements are extremely common in contracts; otherwise, the parties could end up disagreeing later about just what change was agreed to. But in some jurisdictions, such requirements might not be enforceable — on the theory that, in the right circumstances, such requirements can be *orally* waived — as discussed in the commentary at [NONE].

*22.4.1.2 Subdivision a.2: Labeling requirement*

Requiring an amendment to be clearly labeled as such should help reduce the chances that parties will dispute whether a particular communication constituted an amendment. That was an issue in a Fourth Circuit case in which a tenant of an office building signed an estoppel certificate — the court held that the estoppel certificate did not modify the tenant's lease, in part because "the Estoppel Certificate does not label itself as an amendment to the Lease."

Expo Properties, LLC v. Experient, Inc., No. 19-1759, slip op. at 11 (4th Cir. Apr. 15, 2020) (affirming summary judgment).

**Pro tip:** To reduce the chance of possible future confusion, it might be helpful to give an amendment a series number and date in its title, and perhaps even include a (brief) mention of its purpose.

*Example:* "First Amendment, Dated December 25, 20X7, to Asset Purchase Agreement (Increase of Purchase Price)."

**Pro tip:** An extensive amendment could be done as a complete "amended and restated agreement.

*Example:* As of March 22, 2020, the title of the Enterprise Products Partners limited-partnership agreement is "*Sixth Amended and Restated* Agreement of Limited Partnership of Enterprise Products Partners L.P." (emphasis added).

### 22.4.2 What individual(s) must sign an amendment

a. Except as provided in subdivision b, an amendment may be signed, on behalf of a organizational party (a corporation, LLC, etc.), by any individual having apparent authority to do so on.

b. The Contract may specify that an amendment will not be effective unless signed by a particular person or by a person holding a particular title.

*Commentary*

#### *22.4.2.1 Subdivision a: Apparent authority to sign*

A signer's *apparent* authority to sign on behalf of a party will *generally* override the party's *internal* signature policies.

For example in one case, a company was held to be bound by a contract signed by an executive vice president, even though that individual did not have *internal* authorization to sign the contract. See Digital Ally, Inc., v. Z3 Tech., LLC, 754 F.3d 802, 812-14 (10th Cir. 2014); see generally Apparent authority (Wikipedia.org).

#### *22.4.2.2 Subdivision a: Limiting amendment authority*

A contract could expressly limit the range of individuals authorized to sign amendments on behalf of a party; this would (presumably) put the other party on notice that other signers would **not** have "apparent authority" to sign amendments. Such language could be along the following lines:

> An amendment will not be binding on an organization unless it is signed on behalf of the organization by an individual at the vice-president level or higher, or in a comparable position in an organization not having a vice-president.

or

> To be effective against [PARTY NAME], an amendment must be signed by *[e.g., a vice president or higher]* of that party.

Language like this is often seen in boilerplate forms; for example, a car dealer might well ask its customers to sign a contract that explicitly states that the sales person doesn't have authority to offer a better warranty. (That's another case of trying to avoid future "he said, she said" disputes about what was allegedly promised.)

Such language might take a form such as: "NO PERSON HAS AUTHORITY TO MODIFY THESE WARRANTIES ON BEHALF OF THE DEALER EXCEPT A VICE PRESIDENT OR HIGHER."

### 22.4.3 Governing law for this Clause

IF: The parties disagree about whether or how this Clause is to be applied; THEN:

> New York's General Obligations Law 15-301(1) (which expressly validates amendment-in-writing requirements in contracts) is to control the interpretation and application of this Clause,
>
> along with the interpretation of that statutory provision by the state- and federal courts having jurisdiction in New York,
>
> no matter what law might otherwise apply.

*Commentary*

#### *22.4.3.1 The cited New York statute*

New York's General Obligations Law 15-301(1) provides that:

> A written agreement … which contains a provision to the effect that it cannot be changed orally, cannot be changed by an executory agreement *unless* such executory agreement is in writing and signed[:] [i] by the party against whom enforcement of the change is sought or [ii] by his agent.

(Emphasis and bracketed text added.)

#### *22.4.3.2 Purpose of a clause-specific governing law*

It might seem strange to specify a choice of law to govern one particular provision in a contract. But it's not unprecedented, as discussed in the commentary at Section 22.70.14: .

This Clause chooses a New York statute to govern because in some jurisdictions, a court (or other tribunal of competent jurisdiction) might hold that the parties were free to amend the Contract *without* doing so in writing, for example orally, even though the parties had agreed to the amendments-in-writing requirement, which could lead to undesirable uncertainty.

*Example:* Under a century-old New York precedent (which this author refers to as the "**Cardozo Rule**," after its author, later a Supreme Court justice) (now effectively overruled by the statute cited above), parties are free to *orally waive* a contractual requirement that amendments and waivers must be in writing, subject to any possible impact of the statute of frauds.

See Beatty v Guggenheim Exploration Co., 225 N.Y. 380, 387-88 (1919) (Cardozo, J.), *quoted in* Israel v. Chabra, 12 N.Y.3d 158, 163-64 (2009).

And **California still allows oral waiver** of an amendments-in-writing provision. This rule came into play, for example, in a case involving profits from the TV series *Home Improvement*.

The plaintiffs, who were writers and producers of the show, sued the Walt Disney company for failing to properly report and pay profit-based amounts that Disney allegedly owed under its contract with the plaintiffs.

A trial court granted summary judgment in favor of Disney on grounds that a provision in the contract stated that Disney's profit reports and payments would become incontestable after 24 months.

The appeals court reversed, holding that a jury must decide whether Disney *orally waived or agreed to modify* the incontestability provision. See Wind Dancer Production Group v. Walt Disney Pictures, 10 Cal. App. 5th 56, 78-79, 215 Cal. Rptr. 3d 835 (2017).

On the other hand:

• In some jurisdictions, courts will uphold requirements that amendments and waivers must be in writing.

See, e.g., a Seventh Circuit case in which the appeals court, looking to Michigan precedents, upheld summary judgment giving effect to an "anti-waiver" clause in Ford's dealership agreement. DeValk Lincoln Mercury, Inc. v. Ford Motor Co., 811 F.2d 326, 334 & n.2 (7th Cir. 1987).

• The United Kingdom's Supreme Court **expressly rejected** the Cardozo Rule, concluding that "the law should and does give effect to a contractual provision requiring specified formalities to be observed for a variation."

Rock Advert. Ltd v MWB Bus. Exch. Ctrs. Ltd, [2018] UKSC 24 para. 10.

• **A statute** might expressly validate amendments-in-writing and waivers-in-writing provisions.

See, e.g., New York's General Obligations Law 15-301(1), discussed above, as well as UCC § 2-209(2) for amendments to agreements for the sale of goods.

• On the other hand, **a California statute** has been relied on by courts to allow oral waiver of provisions requiring amendments amendments to be in writing.

"Nothing in this section precludes in an appropriate case the application of rules of law concerning estoppel, … [or] waiver of a provision of a written contract…." California Civil Code § 1698(d), *quoted in Wind Dancer Productions*, 10 Cal. App. 5th at 78 (modifications by the court).

### 22.4.4 Stricter proof requirement for alleged oral amendments

a. IF: A court allows a party (the "asserting party") to assert that a non-written amendment is effective notwithstanding the amendments-in-writing requirement of this Agreement;

> THEN: The asserting party must show, by clear and convincing evidence (see the definition in Clause 22.30), that each other relevant party agreed to each of the alleged nonwritten amendments.

b. In case of doubt, this section is not intended as an implicit authorization of non-written amendments.

*Commentary*

As defined in [NONE], *clear and convincing evidence* requires reasonable corroboration of statements by interested witnesses, for reasons explained in the commentary to [NONE].

### 22.4.5 Which party must sign an amendment

To be effective, an amendment must be signed on behalf of at least the party sought be be bound by the amendment.

*Commentary*

#### *22.4.5.1 Language origin: The UCC*

The above one-party signature approach is inspired by the (U.S.) Uniform Commercial Code's statute of frauds provision, which provision requires only that a written contract must be signed "by the party against whom enforcement is sought …." UCC § 2–201.

This one-party signature requirement also comports with a Seventh Circuit holding that "[t]he critical signature *[on an amendment]* is that of the party against whom the contract is being enforced, and that signature was present." See Hess v. Kanoski & Assoc., 668 F.3d 446, 453 (7th Cir. 2012).

#### *22.4.5.2 Alternative: Signed by both parties*

Some parties might prefer amendments to be signed by both parties, using language such as the following:

> To be effective, an amendment must be signed on behalf of by each party.

It seems likely that a court would enforce a contract's requirement that *both* parties sign an amendment.

That happened in a Fourth Circuit case, Expo Properties, LLC v. Experient, Inc., No. 19-1759, slip op. at 10,11 (4th Cir. Apr. 15, 2020) (affirming summary judgment).

#+end$_{ASIDE}$

Why have amendments signed by both parties? Consider this hypothetical example: Suppose that you are an apartment dweller. You and the landlord agree to amend your lease: The landlord agrees to reduce your monthly rent in exchange for your agreeing to extend the lease by one year. Each of you is being bound by the amendment, so each of you must sign it.

**Pro tip:** It's a good *practice* to have amendments signed by all parties, but **it's also better not to *require* signatures by all parties**, in case for some reason one party's signature is not obtained. *(This is an example of the R.O.O.F. drafting principle: Root Out Opportunities for F[oul]ups.)*

### 22.4.6 Terms affected by an amendment

In case of doubt, an amendment will affect only the specific provision(s) of the amended document that are clearly identified in the amendment; all other terms of the amended document will remain in effect as before the amendment.

*Commentary*

This is a comfort clause preferred by some "meticulous" drafters.

See generally, e.g., Title Guaranty Escrow Services, Inc., v. Wailea Resort Co., 456 P.3d 107, 109 (Haw. 2019), where an amendment to the contract in suit contained similar language (the language was not relevant to the lawsuit).

# Clause 22.5 Amendments (Unilateral)

## 22.5.1 Applicability

When agreed to, this Clause will apply if the Contract allows a party, referred to as an "*Amending Party*,"

to unilaterally amend the Contract or a related document,

or some portion of it, such as (without limitation) an annex, schedule, etc.,

without first getting the express agreement of another party.

*Commentary*

See also Tango Clause 22.4 - Amendments.

Unilateral-amendment provisions are fairly common in, e.g., Web sites' terms of service, cable- and telephone-service contracts, and the like.

See, for example, the Facebook Statement of Rights and Responsibilities § 14; Google Terms of Service (under the headline "About These Terms").

## 22.5.2 Unilateral amendment procedure

a. The Amending Party must give the other party at least 30 days' advance written notice of any unilateral amendment that it wishes to make.

b. The notice of amendment must conspicuously (see Section 11.4: ) state the following:

1. that an amendment is being proposed;

2. when the proposed amendment would go into effect;

3. that the other party may opt out of the amendment;

4. the deadline for the other party to take the opt-out action described in subdivision c.2 below; and

5. whether any action on the other party's part would constitute affirmative *acceptance* of the proposed amendment (for example, continuing to use an online service after the effective date of the proposed amendment).

c. The notice of unilateral amendment must also clearly state:

1. the details of the proposed amendment; and

2. what one or more actions the other party may take to opt out of the proposed amendment (for example, giving notice of termination of the Contract, or terminating a user account).

*Commentary*

*22.5.2.1 Opt-out right*

It's pretty conventional for unilateral-amendment provisions to give the non-amending party the right to opt out of the agreement if it doesn't want to accede to a unilateral amendment.

Or, in a mass-market form contract, a unilateral-amendment provision might instead allow (or require) a non-amending party simply to terminate its account with the amending party or to cease utilizing the amending party's services, as opposed to giving notice of termination.

### 22.5.3 No retroactive effect

Any unilateral amendment will be prospective only; that is, the amendment will not substantively expand or limit either party's rights or liabilities under the Contract that had already come into effect as of the effective date of the unilateral amendment.

(Of course, the parties can jointly agree to amend with retroactive effect; see Tango Clause 22.4 - Amendments.)

*Commentary*

*22.5.3.1 Caution — the danger of "illusory" contracts*

If a unilateral-amendment provision might have retroactive effect, then:

- The unilateral-amendment provision might cause some or all of a contract — for example, an arbitration provision with a class-action waiver — to be unenforceable, on grounds that the contract was illusory.
- *That,* in turn might strip a provider of legal protection that the contract might otherwise have provided, in the form of, e.g., an arbitration clause with class-action waiver; a forum-selection or governing-law clause; and so forth.

This is essentially what happened in *Harris v. Blockbuster Inc.*:

A Blockbuster customer sued the company for allegedly violating her privacy rights and sought class-action status.

- Blockbuster sought to parry the suit by moving to compel individual, case-by-case arbitration, as required in the Blockbuster on-line terms of service.
- Harris opposed arbitration, because for her lawyers, many onesie-twosie arbitration proceedings would be *much* less economically attractive than class arbitration.

The court denied Blockbuster's motion to compel arbitration, on grounds that the company's terms of service were "illusory" — because the unilateral amendment didn't include a so-called *Halliburton* exception, discussed below — and therefore was unenforceable under the relevant state law. See Harris v. Blockbuster, Inc., 622 F Supp. 2d 396, 400 (N.D. Tex. 2009), citing In re Halliburton Co., 80 S.W.3d 566 (Tex. 2002).

Much the same occurred in *Carey v. 24 Hour Fitness USA*:

A former employee filed a lawsuit against 24 Hour Fitness. The company moved to compel arbitration, citing an arbitration provision in the company's employee handbook.

The court held that the arbitration provision was unenforceable because the company reserved the right to change the employee handbook at will — and that, in turn, meant that the handbook was "illusory"; consequently, the arbitration provision was ineffective and the former employee's case would be tried in court instead of being heard privately by an arbitrator. See Carey v. 24 Hour Fitness USA, Inc., 669 F.3d 202 (5th Cir. 2012).

• Advance notice of a unilateral amendment might be required to make the amendment effective:

A company's employment handbook contained an agreement to binding arbitration. The handbook also stated that "Any change to this Agreement will only be effective upon notice to Applicant/Employee and shall only apply prospectively." According to the Fifth Circuit, that wasn't enough to save the arbitration agreement from being illusory and therefore unenforceable, because the agreement didn't include the *advance* notice required for the *Halliburton* exception discussed in Section 22.5.3.2: . See Watch House Int'l, LLC v. Nelson, 815 F.3d 190 (5th Cir. 2016) (reversing and remanding order compelling arbitration).

• For agreements that are posted to a Website, just changing the agreement at the Website likely won't be enough notice of a unilateral amendment.

That was the result in a case involving Talk America Inc., a long-distance telephone service provider, which changed its service agreement to require arbitration and a waiver of class actions. See Douglas v. United States District Court ex rel. Talk America Inc., 493 F.3d 1062, 1066 (9th Cir. 2007) (vacating district court's order compelling arbitration).

*Accord*: Stover v. Experian Holdings, Inc., No. 19-55204 (9th Cir. Oct. 21, 2020) (affirming order compelling arbitration; consumer could not claim benefit of new arbitration terms when she had not received notice of the terms); Rodman v. Safeway Inc., No. 11-cv-03003-JST part III-C (N.D. Cal. Dec. 10, 2014) (granting class plaintiff's motion for summary judgment that Safeway had overcharged on-line customers).

#### *22.5.3.2 The Halliburton exception saves the day*

In the cited *Halliburton* case, the Texas supreme court held that an employer could *unilaterally* impose a change the terms of at-will employment to require arbitration of disputes, *as long as* :

- the employer gave advance notice; **and**

- the change did not apply to claims of which the employer had already been given notice.

  See In re Halliburton Co., 80 S.W.3d 566, 569-70 (Tex. 2002); see also Lizalde v. Vista Quality Markets, 746 F.3d 222 (5th Cir. 2014) (reversing denial of motion to compel arbitration).

See also the commentary at [NONE].

### 22.5.4 Additional rejection opportunity for existing disputes

a. If an Amending Party proposes a change to a dispute-resolution procedure in the Contract,

for example, a binding-arbitration provision,

then the other party may reject the proposed change,

by giving the Amending Party notice to that effect within 30 days after the effective date of the Amending Party's notice of unilateral amendment.

b. If the other party does reject the proposed unilateral amendment to the dispute-resolution procedure,

then the Contract's then-existing dispute resolution provisions (if any) will remain in effect,

for any disputes that were pending at (what would otherwise have been) the effective date of the proposed amendment.

c. If the other party does *not* timely reject the proposed dispute-resolution amendment

then the proposed amendment will go into effect as to all disputes,

including but not limited to any dispute that was pending at the time of the notice of unilateral amendment.

*Commentary*

The provision is modeled on a comparable one in section 2 of the Uber ride-sharing terms of service of November 17, 2020 (last visited November 27, 2020).

A somewhat-similar provision was responsible for saving an arbitration clause from invalidation:

An arbitration agreement was terminable by the employer, but it expressly stated that the termination would be prospective only and would not be effective until the employer had given the employee ten days' notice. See Lizalde v. Vista Quality Markets, Inc., 746 F.3d 222, 224 (5th Cir. 2014) (reversing district court's denial of employer's motion to compel arbitration of employee's claim for on-the-job injury).

## Clause 22.6 And/Or Definition

When the term "*and/or*" is used in a list, such as "A, B, C, and/or D," it refers to one or more (or, some or all) of the listed items, not to just one of them.

Hypothetical example: *The parties expect to meet on Tuesday, Wednesday, and/or Thursday*. This means that the parties expect to meet on *one or more* of those days, not just on one and only one of them.

*Commentary*

Some people loathe the term *and/or*. Used properly, however, the term can be a serviceable shorthand; it's equivalent to the inclusive-or, as opposed to the exclusive-or (which is expressed mathematically as XOR).

One state-court judge excoriated the use of *and/or* as "indolent"; the judge — who evidently was no slave to brevity — proclaimed that a drafter could instead "express a series of items as, *A, B, C, and D together, or any combination together, or any one of them alone*." Uh, *sure*, Your Honor ….

Carley Foundry, Inc. v. CBIZ BVKT, LLC, No. 62-CV-08-9791, final paragraph (Minn. Ct. App., Apr. 6, 2010).

More sensibly: Ken Adams, author of A Manual of Style for Contract Drafting, suggests that, when dealing with a list of three or more items, use "one or more of A, B, and C."

Kenneth A. Adams, "A, B, and/or C", (2012), http://goo.gl/m9U3p (adamsdrafting.com).

Granted, it's possible to use *and/or* inappropriately.

See, e.g., the examples collected by Wayne Scheiss, director of the legal-writing program at the University of Texas School of Law, in In the Land of Andorians (Jan. 2013).

But trying to ban *and/or* is likely a bootless errand, because many drafters will use the term anyway. So the better practice is just to define the term and be done with it. (W.I.D.D. — When In Doubt, *Define*!)

**Footnote:** In a related danger, a court could easily read the term *and* as being disjunctive — that is, as tantamount to *or* — *or vice versa*.

See Capital Finance, LLC v. Rosenberg, 364 F. Supp. 3d 529, 540, 544-45, 546 (D. Md. 2019) (citing cases), *aff'd in relevant part*, No. 19-1202, slip op. (4th Cir. Sept. 21, 2020).

# Clause 22.7 Arbitration

## 22.7.1 Introduction

This Clause applies when the Contract calls for some or all disputes to be arbitrated.

*Commentary*

### *22.7.1.1 Background: Overview of arbitration*

Arbitration is, in essence, a form of private dispute resolution in which, *by agreement of the parties*, an arbitrator (or a panel of three arbitrators) *decides* the dispute instead of a court's doing so.

Note that arbitration is **not** the same as mediation, in which a neutral mediator has no authority to *decide* the dispute, but *does* attempt to broker an agreed settlement between the disputing parties, often using "shuttle diplomacy."

Arbitration by agreement is usually **binding**.

By law and treaty (the New York Convention) in the U.S. and many other countries:

- If the parties to a dispute agree to arbitration, and the arbitrator renders an award, then the party that wins the arbitration can go to court to have the arbitrator's award "confirmed," that is, entered into the court records as though it were a judgment of the court itself. See, e.g., 9 U.S.C. § 13 (entry of judgment on arbitration award).

- If the award requires the losing party to pay money to the winning party, but the losing party doesn't pay up, then once the award has been "confirmed" (i.e., entered as a judgment of the court), the winning party can have the confirmed award "executed." This is typically accomplished by obtaining a writ of execution from the court — this is a document commanding the sheriff (or other law-enforcement authority) to seize the losing party's bank funds and deliver

them to the winning party (or to seize the losing party's non-monetary assets, cause them to be sold, and deliver the proceeds to the winning party).

#### *22.7.1.2 Public policy favoring arbitration*

Arbitration used to be disfavored by U.S. courts, but Congress and the Supreme Court have instructed lower courts to reverse that stance.

> The *[Federal Arbitration Act]* was enacted in 1925 **in response to widespread judicial hostility** to arbitration agreements. Section 2, the primary substantive provision of the Act, provides, in relevant part, as follows:
>
> "A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction… shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."
>
> We have described this provision as reflecting both **a liberal federal policy favoring arbitration** and the fundamental principle that **arbitration is a matter of contract**. In line with these principles, courts must place arbitration agreements on **an equal footing with other contracts** and enforce them according to their terms.

AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 131 S. Ct. 1740, 1745-46 (2011) (cleaned up, emphasis added).

#### *22.7.1.3 Some pros and cons of arbitration*

Some parties prefer to arbitrate disputes, because:

• *Properly managed*, arbitration can serve as a faster, less-expensive way of resolving business disputes.

For arbitration-management suggestions, see this streamlining article by the present author — I sometimes serve as an arbitrator in tech-contract and IP disputes — as well as my arbitration procedures.

• For transnational arbitrations: Because of the international treaty on arbitration (the New York Convention), if a case is *arbitrated* in Country A, it's often easier for the winning party to get a court in Country B to enforce the arbitrator's award (e.g., by ordering seizure of the losing party's assets located in Country B) than it would be if the case had been *litigated* in Country A.

But others regard arbitration as being the worst of both worlds; it has been said that —

• Arbitration has supposedly been "captured" by litigation counsel who, for reasons of their own, prefer to agree with their counterparts to run arbitration proceedings in the same, expensive- and time-consuming ways as they're familiar with in court; and

• Arbitrators — desirous of getting *future* business from counsel — can be reluctant to anger counsel by overruling them, even though that would help to keep costs down.

See Thomas J. Stipanowich, Arbitration: The New Litigation, 2010 Ill. L. Rev. 1.

#### *22.7.1.4 Consider "baseball" arbitration*

To promote settlement, drafters should *seriously* consider including a "baseball" arbitration clause such as that of [NONE], for reasons discussed in the commentary there.

#### *22.7.1.5 Pro tip: Be clear that arbitration is mandatory*

An arbitration clause should be very clear that arbitration is mandatory: Feel-good language making it seem that arbitration is optional can kill an arbitration requirement.

In one case, the arbitration clause said that "[i]f the dispute is not resolved through mediation, the parties *may* submit the controversy or claim to Arbitration. *If the parties agree to arbitration*, the following will apply: …."

In that case, both the trial court and appellate court concluded that under the arbitration clause, arbitration was not *required* and therefore the appellant's motion to compel arbitration must be denied. Quam Construction Co. v. City of Redfield, 770 F.3d 706, 708 (8th Cir. 2014) (emphasis edited).

### 22.7.2 Broad definition of "arbitrable dispute"

To the extent not affirmatively prohibited by law, the parties must arbitrate any Agreement-Related Dispute (see the definition in Clause 22.3) in accordance with this Clause. This includes, without limitation, the following:

1. any claim under a statute or a common-law doctrine; and
2. any claim that a party was induced to enter into the Contract by another party's fraud or negligent misrepresentation.

*Commentary*

#### *22.7.2.1 Statute-based claims can be arbitrable — if so agreed*

American courts have held that statute-based claims can be arbitrated, but only if the parties agree.

• An employer tried to force an employment-discrimination case to be heard in arbitration under the employer's collective-bargaining agreement ("CBA") with a union. The employer managed to convince the district court to rule in its favor.

But the Fifth Circuit disagreed: The appeals court said that the arbitration provision in the CBA didn't cover discrimination claims because the provision didn't include a clear and unmistakable statement that statutory claims were to be arbitrated. See Ibarra v. United Parcel Service, 695 F.3d 354, 356 (5th Cir. 2012) (reviewing Supreme Court cases; vacating and remanding summary judgment in favor of employer).

• In contrast, another employer's collective-bargaining agreement *did* include what the [U.S.] Supreme Court described as "a provision … that clearly and unmistakably requires union members to arbitrate claims arising under the Age Discrimination in Employment Act of 1967 (ADEA)"; the Court held that *that* arbitration provision *was* enforceable. See 14 Penn Plaza LLC v. Pyett, 556 U.S. 249 (2009) (reversing court of appeals; citation omitted).

#### *22.7.2.2 BUT: Not all claims will be forced into arbitration*

Not all arbitration provisions will be readily enforced by U.S. courts. For example:

• Drafters working in the financial-services arena should check the Dodd-Frank Act's prohibition of mandatory arbitration of Sarbanes-Oxley Act "whistleblower" claims.

> See generally, e.g., Federal Courts Split on Whether Dodd-Frank's Bar on Arbitration of Whistleblower Retaliation Claims Under Sarbanes-Oxley Is Retroactive (Oct. 9, 2012) (sutherland.com).

BUT: The Second Circuit has held that this prohibition does *not* bar mandatory arbitration of whistleblower-retaliation claims. See Daly v. Citigroup, Inc., 939 F.3d 415 (2d Cir. 2019) (affirming order compelling arbitration).

• In the Truth in Lending regulations, Regulation Z prohibited pre-dispute arbitration clauses in mortgages secured by dwellings until overturned in 2017 by the GOP Congress and President Trump.

• Government contractors and subcontractors should check "Franken Amendment" restrictions on arbitration clauses in employment agreements relating to certain government contracts.

> See, e.g., Frank Murray, Assessing the Franken Amendment (Feb. 16, 2011).

Moreover, in July 2014, President Obama signed an executive order stating that in federal government contracts for more than $1 million, "contractors *[must]* agree that the decision to arbitrate claims arising under Title VII of the Civil Rights Act of 1964 or any tort related to or arising out of sexual assault or harassment may only be made with the voluntary consent of employees or independent contractors after such disputes arise"; the order includes a flowdown requirement for subcontracts for more than $1 million.

(The order sets out exceptions for (i) the acquisition of commercial items or commercially available off-the-shelf items; (ii) collective bargaining agreements; and (iii) some but not all arbitration agreements that were in place before the employer placed its bid for the government contract in question.)

The Fourth Circuit has held, however, that when accounting firm PricewaterhouseCoopers ceased being a government contractor, the firm regained its right to enforce the mandatory-arbitration provision in its employment agreements. See Ashby v. PricewaterhouseCoopers LLP, No. 18-1958 (4th Cir. Apr. 3, 2020) (reversing and remanding denial of motion to compel arbitration).

• Federal law provides that in franchise agreements between automobile manufacturers and their dealers, pre-dispute arbitration agreements are unenforceable.

See 15 U.S.C. § 1226(a)(2).

• The regulations implementing the Military Lending Act render unenforceable *any* agreement to arbitrate consumer credit disputes between lenders and active-duty military personnel or their eligible dependents.

These regulations do not distinguish between pre-dispute and post-dispute agreements to arbitrate, even though the statute appears to make just such a distinction. See 10 U.S.C. § 987(e)(3), implemented in 32 C.F.R. § 232.9(d).

• Federal regulations governing livestock and poultry production impose restrictions on certain contracts mandating the use of arbitration.

Under these regulations, such contracts must include, *on the signature page*, a specifically-worded notice, in conspicuous bold-faced type, allowing the producer or grower to decline arbitration; moreover, the Secretary of Agriculture seems to have the power to review agreements to determine "whether the arbitration process provided in a production contract provides a meaningful opportunity for the poultry grower, livestock producer, or swine production contract grower to participate fully in the arbitration process." 9 C.F.R. § 201.218.

#### *22.7.2.3 Arbitration of employee claims at NLRB, etc.*

Anyone drafting an arbitration clause for an *employment* agreement should consider that the (U.S.) National Labor Relations Board has held that a mandatory arbitration provision, in a company's sales-commission agreement, unlawfully interfered with employees' right of access to the Board's processes, in violation of section 8(a)(12) of the National Labor Relations Act.

The Board distinguished the arbitration provision from another arbitration provision that contained an adequate exception for Board charges. See Beena Beauty Holding, Inc., 368 NLRB No. 91 (2019); see also, e.g., Four Seasons Healthcare & Wellness Center, LP, 370 NLRB No. 8 (2020) (arbitration provision saved by an exception for Board charges).

### 22.7.3 Exception for small claims

a. *Who may opt out:* Either party may opt out of arbitrating a claim, and instead take the claim to a court of competent jurisdiction, if (but only if), all told, the aggregate amount being sought under the claim is no more than USD $10,000.

b. *Required court for small claims opt-out:* If the Contract includes a forum-selection provision (see [NONE]), then the opted-out small claim must be brought in a court permitted by that provision.

c. *Class action?* In case of doubt:

1. this small-claims exception to arbitration does not itself authorize class- or collective-action arbitration (see below); and

2. if either party asserts that the claim must be arbitrated despite this small-claims exception, then that assertion is to be decided by the court, and the arbitral tribunal will have no power to do so.

*Commentary*

Arbitration is not cost-free, because arbitrators and arbitration administrators charge for their services. If a particular dispute doesn't have a lot of money at stake, it probably would be more cost-effective for the parties to take the dispute to small-claims court instead.

*Alternative:*

> All otherwise-arbitrable claims must be arbitrated, no matter how small the amount in controversy is.

Subdivision c.2: This carve-out is an exception to the delegation of arbitrability disputes in [NONE]. (Concerning the "no power" phrasing, see the commentary at Section 22.7.17.1: .)

See also [NONE] concerning class arbitration.

### 22.7.4 Arbitral law

Any arbitration is to be governed by the internal laws of the State of Texas.

*Commentary*

This section adopts Texas arbitration law for U.S. arbitrations, because Texas law lays out a sensible process that allows:

- compulsory depositions of adverse witnesses — but outside of Texas, of course, that provision might well be unenforceable against non-party witnesses; and
- an expanded right of appeal if desired (discussed in more detail at [NONE]), which is not available under the Federal Arbitration Act per se.

  See Tex. Civ. Prac. & Rem. Code §§ 171.050 and 171.051.

Note that in the U.S., the Federal Arbitration Act will generally apply in cases involving or affecting interstate commerce "absent clear and unambiguous contractual language to the contrary" — and this section does *not* attempt to rule out applying the FAA — in which the contract "*expressly* references state arbitration law."

BNSF R.R. Co. v. Alston Transp., Inc., 777 F.3d 785, 790-92 (5th Cir. 2015) (vacating district court's vacatur of arbitration award and remanding with instructions to reinstate award) (cleaned up; citations omitted).

Nor does this section try to specify a particular governing law for *non-U.S.* arbitrations, because that would be subject to too much variation.

### 22.7.5 Arbitration rules

a. *Applicable rules:* Any arbitration is to be governed by:

1. the Commercial Arbitration Rules of the American Arbitration Association ("*AAA*"), for cases where all parties to the arbitration are citizens and/or residents of the United States, or

2. the International Arbitration Rules of the International Centre for Dispute Resolution ("ICDR"), the international division of the AAA, otherwise,

in either case, as in effect at the time of the demand for arbitration.

b. *Choice of rules, not of forum:* In case of doubt, the parties' agreement to the arbitration rules is intended as a choice of *rules* and not of *forum*.

*Commentary*

*22.7.5.1 Subdivision a: AAA / ICDR rules*

Many arbitration rules are sufficiently well-developed that they could be thought of as the arbitral version of the Federal Rules of Civil Procedure: Once you agree to such rules, you've agreed, in great detail, how any arbitration proceeding would be conducted.

Drafters have considerable choice in their selection of arbitration rules, such as, for example:

• For U.S. arbitrations, [NONE] specifies the Commercial Arbitration Rules of the American Arbitration Association, which are a typical "default" standard in the U.S.

The AAA also has expedited rules that can be used if desired, as well as rules for appeal of arbitration awards to an appellate panel of arbitrators. *(Disclosure: The author is a member of the AAA's commercial arbitration panel.)*

• For non-U.S. arbitrations, [NONE] specifies the International Arbitration Rules of the International Centre for Dispute Resolution ("ICDR"), the international division of the AAA.

The ICDR rules are said to be based on the UNCITRAL Rules (mentioned below) but with administration features included.

For a discussion of the 2014 revisions to the ICDR rules, see Eduardo R. Guzman and Joseph M. Kelleher, International Centre for Dispute Resolution ("ICDR") Revised Rules Came Into Effect on June 1, 2014.

• The LCIA Arbitration Rules of the London Court of International Arbitration (LCIA) are popular in international arbitrations.

• The ICC arbitration rules of the International Chamber of Commerce (ICC) are believed to be among the most popular world-wide, in part because the arbitration award prepared by the Arbitral Tribunal will be scrutinized, before being released to the parties, by the ICC's International Court of Arbitration.

Others, though, believe that these putative benefits must be weighed against the likely cost of an ICC arbitration; see, e.g., Latham & Watkins, Guide to International Arbitration, ch. IV.

• The UNCITRAL arbitration rules do not provide for administration; to some, the absence of administration would be a serious deficiency.

• The World Intellectual Property Organization (WIPO) has published arbitration rules and expedited arbitration rules.

• The JAMS Streamlined Arbitration Rules have been praised by some arbitrators as effective; JAMS also has a set of international arbitration rules.

• The International Institute for Conflict Prevention and Resolution (CPR) rules are favored by some.

For a brief comparison of various rules, see an article by Mark Anderson on the IP Draughts blog at http://goo.gl/ZX1iy.

For a more-detailed comparison of arbitration rules in the U.S. (AAA, JAMS, and CPR), see Liz Kramer, ArbitrationNation Roadmap: When Should You Choose JAMS, AAA or CPR Rules?

For international arbitration, see this October 2014 chart (CorporateCounsel.com), by Kiera Gans and Amy Billing, of selected key aspects of different rules.

#### *22.7.5.2 Subdivision b: Choice of forum, not rules*

This subdivision seeks to avoid the result in the Second Circuit's 1995 Salomon securities class-action case, where an arbitration provider's refusal to accept a case resulted in the court's ruling that this negated the parties' agreement to arbitrate.

See In re Salomon Inc. Shareholders' Derivative Lit., 68 F.3d 554 (2d Cir. 1995); see also, e.g., PoolRe Ins. Corp. v. Organizational Strategies, Inc., 783 F.3d 256 (5th Cir. 2015) (citing cases).

Other courts have reached the opposite result, holding that, just because the designated arbitral body isn't available, that won't negate the agreement to arbitrate unless that designation was material to the agreement.

See, e.g., Ferrini v. Cambece, No. 2:12-cv-01954 (E.D. Cal. June 3, 2013) (citing cases); Nachmani v by Design, LLC, 901 N.Y.S.2d 838, 74 A.D.3d 478 (N.Y. App. Div. 2010) (agreement to AAA rules was choice of rules, not of administrator).

### 22.7.6 Arbitral tribunal: Number of arbitrators

The arbitral tribunal is to consist of a single arbitrator.

*Commentary*

At least in theory, three arbitrators are more likely than a single arbitrator to consider everything that needs to be considered and not overlook significant issues or evidence. It's also possible that a reviewing court might be more inclined to confirm an arbitration award rendered by three arbitrators instead of just one.

BUT: Many arbitrators and counsel agree that three arbitrators will cost more than three times the cost of a single arbitrator, because three arbitrators will spend time conferring with each other and negotiating the language of the award.

Contract negotiators therefore might want to specify appointing a single arbitrator in cases of comparatively low value, perhaps using three arbitrators for "big" cases.

Under Rule R-16 of the AAA's Commercial Arbitration Rules, the AAA can in its discretion decide to appoint three arbitrators, but otherwise a single arbitrator is used unless the arbitration agreement specifies otherwise.

### 22.7.7 Arbitral tribunal: Selection

The arbitral tribunal is to be selected:—

1. as provided in the arbitration rules or,
2. failing that, as provided by law.

*Commentary*

#### *22.7.7.1 Purpose of arbitrator selection by law*

This section takes into account that the arbitrator selection method prescribed by the arbitration rules might not succeed in picking a tribunal. In that circumstance, a court might refuse to compel arbitration. At this writing, this is the subject of a circuit split among U.S. federal courts. For that reason, this section says that a court can serve as a backup selector.

See Frazier v. Western Union Co., 377 F. Supp. 3d 1248, 1265-66 (D. Colo. 2019) (citing cases); cf. Trout v. Organización Mundial de Boxeo, Inc., 965 F.3d 71, 82 (1st Cir. 2020), discussed in the next section.

#### *22.7.7.2 Should a party get to choose, or even be, the arbitrator?*

Some arbitration agreements, especially in sports, provide for a senior authority figure in one of the parties to serve as arbitrator. Consider, for example, the famous "Deflategate" case, which centered on legendary (U.S.) National Football League quarterback Tom Brady. The Second Circuit rejected Brady's contention that NFL commissioner Roger Goodell could not properly sit as arbitrator in Brady's challenge of his four-game suspension, holding in essence that that the players' union and the team owners had known full well the consequences of their agreement, and that they could have done things differently if they wished.

See NFL Mgmt. Council v. NFL Players Ass'n, 820 F.3d 527, 548 (2016).

On the other hand, the First Circuit held that, under the applicable Puerto Rican law, the arbitration provision in the World Boxing Organization's agreement with boxers was unconscionable because it gave the WBO the power to select the arbitrator.

See Trout v. Organización Mundial de Boxeo, Inc., 965 F.3d 71 (1st Cir. 2020). The appeals court remanded the case for consideration of a savings clause that might allow arbitration to go forward anyway with an arbitrator appointed by the district court. *See id.*, 965 F.3d at 82.

In an earlier California case, an appeals court held that a "review committee" procedure in an employer's "Employee Guide" did not constitute an agreement to arbitrate because "a third party decision maker and some decree of impartiality must exist for a dispute resolution mechanism to constitute arbitration." Cheng-Canindin v. Renaissance Hotel Associates, 50 Cal. App. 4th 676, 687 (1996).

### 22.7.8 Arbitral tribunal: Arbitrator qualifications

The Contract may specify particular arbitrator qualifications, but if an arbitrator lack those particular qualifications, it will not affect the validity or enforceability of any award by the tribunal unless either party objects to the member's participation:

1. within the time provided by the arbitration rules; or

2. if the arbitration rules do not provide a time limit for objection, within ten business days after being informed in writing (by any means) of the tribunal member's appointment.

*Commentary*

Some contracts (usefully) specify different arbitrator qualifications for different types of dispute. One such case involved the sale of certain oil and gas properties for $1.75 billion; the contract called for *title* disputes to be arbitrated by consultants familiar with the energy industry, but for *accounting* disputes to be arbitrated by an accounting referee.

See BP America Production Co. v. Chesapeake Exploration LLC, 747 F.3d 1253, 1256 (10th Cir. 2014) (affirming a variety of orders by the district court).

**Caution:** A very few contracts get extremely (and overly) explicit about who may serve as an arbitrator, e.g., "ten years practicing law in the computer-software field and five years' experience as an arbitrator." Doing that, though, might seriously limit the pool of available arbitrators.

### 22.7.9 Arbitration administrator

Unless unambiguously agreed otherwise, the arbitration is to be administered by:

1. if all parties to the arbitration are citizens and/or residents of the United States: the American Arbitration Association;

2. all other arbitrations: the International Center for Dispute Resolution; or

3. if no agreed-to administrator is willing or able to serve in that role: the arbitral tribunal.

*Commentary*

As far as "administration" of arbitration goes, it comes in two flavors: Administered, and ad hoc. Among the reasons to prefer administered arbitration: Arbitration requires doing a number of chores such as scheduling, invoicing, etc. It's usually more cost-effective to have those chores handled by the AAA, the ICC, or other arbitral institution, than it would be to pay the arbitrator's hourly rate.

Moreover, an experienced arbitrator points out that:

• "AAA's vetting process formalizes disclosures of potential conflicts/biases and thus minimizes *[sic; reduces]* the likelihood of a flawed proceeding."

• In addition, a party might have a complaint about an arbitrator, for example a perception that the arbitrator is biased toward another party. It will usually be better if the complaining party can take its complaint to an arbitral institution, than to risk angering the arbitrator by raising the complaint with the arbitrator himself.

• And "a competent administrator will goad an arbitrator who is not moving the proceeding apace."

Gary McGowan, 12 Ways to Achieve Efficiency and Speed in Arbitration, Corporate Counsel (Apr. 22, 2013) (modified for readability) (now behind a paywall).

Another commentator says that "the conventional wisdom is that it is easier to enforce an award given by an arbitral institution than one given by an ad hoc arbitrator."

Eric S. Sherby, A Checklist for Drafting an International Arbitration Clause (Sept. 10, 2010).

Quite a few arbitration-administration organizations are available.

Examples:

- the American Arbitration Association ("AAA") or its International Centre for Dispute Resolution (Disclosure: The present author is a member of the AAA's panel of commercial arbitrators)
- JAMS
- the International Institute for Conflict Prevention and Resolution (CPR)
- the London Court of International Arbitration (LCIA)
- the International Court of Arbitration of the International Chamber of Commerce

### 22.7.10 Arbitration location

The arbitration hearing is to be conducted in the location specified by the arbitration rules, which is to be considered the "seat" of the arbitration.

*Commentary*

The choice of arbitral location — sometimes referred to as the "seat" of the arbitration — can have significant procedural implications, such as in determining the arbitral law. (The arbitration rules might specify the arbitral location to be applied in the absence of the parties' agreement otherwise.)

*Example:* Suppose that the parties' agreement specifies that the arbitral location will be (say) London, but the agreement does not specify an arbitral law. In that case, procedurally the arbitration proceedings might well be governed by English arbitration law — even if the agreement's governing-law provision specified another law to govern the interpretation and enforcement of the Agreement.

See, e.g., Zurich American Insurance Co. v. Team Tankers A.S., 811 F.3d 584, 588 (2d Cir. 2016).

### 22.7.11 Arbitral language

The English language, as used in the United States, is to be used for all proceedings, notices, and decisions in the arbitration.

*Commentary*

In transnational contracts, the parties might well be fine with using English, the global *lingua franca* of business, as the arbitral language. But drafters should also consider where an arbitration award might have to be **enforced**, with an eye to reducing the expense (and time delay) of providing **a sworn translation**, which might be necessary under Article IV.2 of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention).

Requiring **notices** to be in the arbitral language could be important.

*Example:* A U.S. retailer, in a business relationship with a Chinese manufacturer, was served with a notice of arbitration — *written in Chinese*. The retailer did not get the notice translated in time. As a result, the retailer found itself losing an arbitration in China, and having a sizable damages award entered against it. Fortunately for the retailer, a U.S. court refused to enforce the award, on grounds that a different agreement controlled, under which the arbitration notice was required to be in English, not Chinese. See CEEG (Shanghai) Solar Science & Tech. Co. v. LUMOS LLC, 829 F.3d 1201 (10th Cir. 2016), *affirming* No. 14-cv-03118 (D. Colo. May 29, 2015).

(The *CEEG* case also illustrates the principle that a contract might be worthless if the assets of a party that breaches the contract are effectively beyond the reach of the other party.)

### 22.7.12 No class arbitration

a. Unless the Contract clearly and unmistakably states otherwise, a claimant must arbitrate only its own dispute —

1. without consolidation with claims of other parties, and

2. without purporting to be (i) a plaintiff or representative class member in a purported class action, collective action, or representative proceeding, nor (ii) a private attorney general under laws such as (for example) California's Private Attorneys General Act.

b. The arbitral tribunal will have no power to decide whether arbitration is allowed in any manner other than as stated in this Clause unless the Contract expressly and unmistakably allows class arbitration.

*Commentary*

#### *22.7.12.1 Why no class arbitration?*

In the United States, the Supreme Court has held that a *class* arbitration is not permitted under the Federal Arbitration Act unless the parties *expressly* agreed to it, on grounds that arbitration differs from litigation in crucial ways and that a party's consent to *class* arbitration could not be inferred or implied.

A majority of the Court took the view that arbitration is so different from litigation — with very different procedures and, crucially, very little right of appeal — that the "default" rule, at least for arbitrations under the Federal Arbitration Act, is that class-action arbitration is not allowed unless the parties expressly agree to it: "[C]lass-action arbitration changes the nature of arbitration to such a degree that it cannot be presumed the parties consented to it by simply agreeing to submit their disputes to an arbitrator"; the Court listed several examples of these changes, for example the significant raising of the stakes with little prospect of appellate review. See Stolt-Nielsen SA v. AnimalFeeds International, 559 U.S. 662, 130 S. Ct. 1758, 1775 (2010).

In other cases, the Court has similarly held that:

- The Act preempts state law barring enforcement of a class-arbitration waiver.

  See AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 131 S. Ct. 1740 (2011) (reversing Ninth Circuit); *see also, e.g.*, Davis v. Nordstrom, Inc., 755 F.3d 1089, 1092-94 (9th Cir. 2014) (reversing denial of Nordstrom's motion to compel employee to arbitrate her claims individually and not as a class)

- A contractual waiver of class arbitration is enforceable under the Act even if the plaintiff's cost of individually arbitrating a federal statutory claim exceeds the potential recovery.

  See American Express Co. v. Italian Colors Restaurant, 133 S. Ct. 2304 (2013) (reversing Second Circuit).

**Caution:** Drafters should be extremely explicit that class arbitration is not allowed; otherwise, a court might well find that the court had no power to overrule the arbitrator's conclusion that class arbitration *was* allowed, as discussed in the next section.

#### *22.7.12.2 Subdivision b: Court is to decide class-arbitration questions*

This subdivision is informed by a Supreme Court holding that if an arbitration agreement *delegates to the arbitrator* the decision whether class arbitration is allowed (see [NONE]), then the arbitrator's decision about class-action arbitrability *cannot be overruled by a court* except on extremely-limited grounds.

See Oxford Health Plans LLC v. Sutter, 569 U.S. 564 (2013) (affirming denial of motion to vacate arbitrator's approval of class action).

Arbitrator mischief might be countenanced by this Supreme Court holding: The present author once read an arbitration award in which the arbitrator held that class arbitration was *implicitly* agreed to — egregiously (IMHO) flouting the Supreme Court's contrary direction in *Stolt-Nielsen* (see the discssion in Section 22.7.12.1: ). After *Oxford Health Plans*, it's not clear that such a misguided arbitrator holding could be overturned in court.

#### *22.7.12.3 No class arbitration? Be careful what you wish for …*

The food-delivery service DoorDash used a contract with delivery drivers that included an arbitration clause that prohibited class arbitrations — so thousands of drivers flooded DoorDash with demands for arbitration, and the company was ordered to pay $9.5 million in arbitrator fees as required by the contract.

See Nicholas Iovino, DoorDash Ordered to Pay $9.5M to Arbitrate 5,000 Labor Disputes (CourthouseNews 2020).

Likewise, more than 5,000 food-delivery drivers for Postmates, Inc., submitted arbitration demands, but Postmates refused to tender its share of the arbitration costs, claiming that "the demands are tantamount to a de facto class action in violation of the class action waiver." The court granted the drivers' motion to compel arbitration so that *the arbitrator* could take up Postmates's claim, as required by the arbitration provision's delegation clause.

The court said: "… the possibility that Postmates may now be required to submit a sizeable arbitration fee in response to each individual arbitration demand is a direct result of the mandatory arbitration clause and class action waiver that Postmates has imposed upon each of its couriers."

(The court later ordered that Postmates show cause why it should not be held in civil contempt for violating the order compelling arbitration, and still later refused to grant a stay to allow Postmates to appeal.)

See Adams v. Postmates, Inc., No. 19-3042 SBA, slip op. at 1-2, 7 n.2 (N.D. Cal. Oct. 22, 2019).

#### *22.7.12.4 Allow opting out of a class-arbitration prohibition?*

Some companies include opt-out provisions in their arbitration agreements, especially in employment agremeents and customer agreements. Opting out of arbitration would preserve an employee's or customer's right to bring class-action litigation.

Many people might not actually bother to opt out; this was the case in a Ninth Circuit appeal, where an employee failed to timely opt out of arbitration when given the chance, and so was held to have waived the right to go to court.

See Johnmohammadi v. Bloomingdale's, Inc., 755 F.3d 1072, 1074 (9th Cir. 2014) (affirming grant of Bloomingdale's motion to compel arbitration of employee's claim and dismissal of her class-action suit).

#### *22.7.12.5 Alternative: Allow class arbitration?*

Parties wishing to allow class arbitration could consider using the following in the Contract:

> Class arbitrations are permitted in accordance with the Supplementary Rules for Class Arbitrations of the American Arbitration Association.

Parties agreeing to class arbitration might also want to agree to an enhanced right of appeal, as stated in [NONE].

### 22.7.13 Forum for enforcement of arbitration award

a. An arbitration award may be confirmed or otherwise enforced in any forum having jurisdiction.

b. The Contract may specify that a particular forum is the only permissible forum for enforcement.

*Commentary*

One or another party to an arbitration might want to have the ability to enforce, or challenge, the award in a preferred jurisdiction; this section provides a vehicle for specifying the jurisdiction.

See also Tango Clause 22.63 - Forum Selection.

### 22.7.14 Preliminary relief

a. A party may seek temporary, interim, or preliminary injunctive relief, in accordance with applicable law, from one or more of (i) a court or other tribunal of competent jurisdiction; and/or (ii) the arbitral tribunal.

b. A party's seeking of such relief in court (or other forum), instead of from the arbitral tribunal, will not in itself waive that party's right to arbitrate.

c. If a party seeks such relief in a court, then the arbitrability of that request for relief is to be decided by that court.

*Commentary*

This section leaves it up to the relevant tribunal to decide whether a party's request for preliminary relief must be arbitrated — to try to avoid the extra expense and uncertainty that, in one still-unresolved case, is requiring not one but two trips to the (U.S.) Supreme Court.

See Henry Schein, Inc. v. Archer & White Sales, Inc., 586 U.S. __, 139 S. Ct. 524 (2019), *on remand,* 935 F.3d 274, 283 (5th Cir. 2019), *cert. granted*, No. 19-963 (U.S. Jun. 15, 2020).

### 22.7.15 Authority to decide arbitrability disputes

Except as otherwise provided in this Clause or elsewhere in the Contract, the parties delegate to the arbitral tribunal the authority to decide any claim whether — for any reason — a particular dispute between the parties is *not* to be arbitrated, unless the dispute manifestly and indisputably does not fall within the scope of the parties' agreement to arbitrate.

*Commentary*

*22.7.15.1 Background: Who decides arbitrability?*

If parties disagree about whether a particular dispute must be arbitrated, it can matter greatly whether the arbitration agreement "delegates" this decision to the ar-

bitrator. Such a disagreement might arise about (for example) the following questions:

- whether the parties in fact entered into an agreement to arbitrate that covers the particular dispute in question;
- whether the agreement to arbitrate (if any) is binding; is enforceable; and/or is in conflict with a non-waivable legal right; and
- whether a party seeking arbitration has waived arbitration.

Delegating such arbitrability disputes to the arbitrator, instead of having a court decide, helps to avoid piecemeal litigation. That's because under U.S. law, it's the court, not the arbitrator, that normally must determine whether the parties have agreed to arbitrate — *but the arbitration agreement itself can clearly and unmistakably delegate that power to the arbitrator*, in which case the arbitrator will decide that question.

> See First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938 (1995) (reversing court of appeals and holding that agreement in question did not give arbitrator power to determine arbitrability).

Of course, even then, any challenge specifically to the "delegation agreement" itself will be heard by the court.

> See Rent-a-Center, West, Inc. v. Jackson, 561 U.S. 63, 68-69 (2010) (reversing 9th Circuit holding that court must determine enforceability of arbitration agreement).

#### *22.7.15.2 The arbitration rules might include a delegation provision*

Many arbitration rules include a delegation provision; if an arbitration agreement adopts those rules, then the delegation agreement follows automatically.

> See, e.g., the American Arbitration Association's Commercial Arbitration Rules, which were the agreed rules in Henry Schein, Inc. v. Archer & White Sales, Inc., 586 U.S. __, 139 S. Ct. 524, 528 (2019), *on remand,* 935 F.3d 274, 283 (5th Cir. 2019), *cert. granted*, No. 19-963 (U.S. Jun. 15, 2020).

#### *22.7.15.3 Challenges to the arbitration agreement itself*

A related issue: What if a party claims that it never agreed to an arbitration agreement in the first place? In that situation, then the arbitration clause's adoption of won't be enough to delegate the arbitrability dispute.

> See VIP, Inc. v. KYB Corp., 951 F.3d 377, 385-86 (6th Cir. 2020) (affirming denial of motion to compel arbitration). For a useful survey of the law in this area, see Paul T. Milligan, Who Decides the Arbitrability of Construction Contracts? in The Construction Lawyer, Vol. 31, No. 2, Spring 2011.

See also this Clause's specific carve-outs, in [NONE] and [NONE], from the delegation of authority to the arbitrator.

### 22.7.16 Confidentiality obligations in arbitration

a. The obligated parties described in subdivision b below must, at all times:

1. maintain in confidence all non-public information disclosed, in the course of the arbitration proceedings, by any party to the arbitration;

2. use any such information only for purposes of the arbitration and any related court proceedings; and

3. not disclose any such information to any third party, except to the minimum extent authorized or required by: (i) the arbitration rules; (ii) the disclosing party; or (iii) applicable law.

b. The confidentiality obligations of subdivision a are intended to be binding on:

1. each party to the dispute;

2. each member of the arbitral tribunal; and

3. each other participant in the arbitration proceedings.

c. To the extent that any other persons listed in this section are subject to a party's control,

for example, party employees, contractors, etc.,

that party is to ensure that the person:

a. agrees in writing to comply with the confidentiality obligations of this Clause, and

b. if the person is an organization: causes its own employees, and others under its direction, to do the same.

a. But if someone breaches the confidentiality obligations of this section, that will not affect the enforceability of any arbitration award.

*Commentary*

*22.7.16.1 Confidentiality requirements in arbitration rules*

A primary reason parties opt to arbitrate their disputes is to try to avoid having their business affairs made public in court proceedings. The agreed arbitration rules might include confidentiality provisions.

Examples:

- Rule R-23(a) of the Commercial Arbitration Rules of the American Arbitration Association allows the arbitrator to impose secrecy requirements in connection with the pre-hearing

exchange of confidential information and the admission of confidential evidence at the hearing.

- Article 30 of the LCIA Arbitration rules of the London Court of Interntional Arbitration automatically provide for secrecy of arbitration proceedings.

A survey of some relevant holdings in various countries, and of various arbitration rules that do or do not contain confidentiality provisions, can be found in a 2007 article (paywalled). See Claude R. Thomson & Annie M. K. Finn, Confidentiality in Arbitration …, *Dispute Resolution Journal*, May-Jul 2007 (paywalled).

#### *22.7.16.2 The arbitral law might require confidentiality*

Local law governing the arbitration might independently require confidentiality. For example, apparently English arbitration law *implies* a duty of confidentiality in arbitration proceedings; a failure to maintain confidentiality where required may result in the imposition of severe sanctions or the institution of legal proceedings against the discloser by other parties to the arbitration.

> See generally Chantal du Toit, Reform of the English Arbitration Act 1996: a nudge towards reversing the presumption of confidentiality (PracticalLaw.com 2017).

Independently of arbitration law, the applicable *substantive* law might impose a duty of confidentiality, for example if personal health information or export-controlled information is involved.

### 22.7.17 Limits on arbitral tribunal's power

a. *Introduction:* Under this Clause, the arbitral tribunal has no power to award relief in contravention of this section.

b. *Award must conform to law:* The arbitral tribunal will have no power to award relief of a kind that a court could not award if the dispute were being litigated instead of being arbitrated,

> taking into account the applicable law — including, without limitation, any applicable statute of limitation or of repose.

c. *Award must conform to contract:* The arbitral tribunal will have no power to award relief inconsistent with the Contract, including, without limitation:

> 1. any agreed limitation of liability — and that term includes, without limitation, exclusions of remedies; and
>
> 2. any shortened limitation period stated in the Contract.

*Commentary*

#### *22.7.17.1 Subdivision a: No arbitrator power*

The language, "has the power only to award such relief," has in mind that, under the (U.S.) Federal Arbitration Act, one of the very few grounds allowing a federal court to vacate an arbitration award is that "the arbitrators exceeded their powers …."

9 U.S.C. § 10(a)(4).

#### *22.7.17.2 No amiable compositeur or ex aequo et bono*

Subdivision a's power-limitation language might be especially important because, under the law and the agreed arbitration rules, an arbitrator might have the power to decide a case as she sees fit, in accordance with her own notions of fairness, and the arbitrator might not need to stay within the strict bounds of either the agreement or the law.

The legalese names for this arbitrator freedom to go beyond the law and the contract are:

- *amiable compositeur*, which refers to the arbitrator's varying what would otherwise be the effect of the law and the parties' agreement; and
- *ex aequo et bono*, which refers to the arbitrator's deciding the case "according to the equitable and good."

See generally, e.g., Alexander J. Belohlavek, *Application of Law in Arbitration, Ex Aequo et Bono and Amiable Compositeur* (2013), available at SSRN: https://ssrn.com/abstract=2230302.

Such expansive arbitrator freedom can sometimes cause parties to fear that an arbitrator might "go rogue," imposing an award that no one could have foreseen, acting on his or her own individual sense of justice.

And depending on the applicable law and the arbitration rules, such fear might not be unwarranted: while most arbitrators seem to stick to the law and the contract, it's not unheard of for arbitrators to "get creative" in fashioning awards.

*Example:* Some thought the arbitrators ran amok in a software-copyright dispute between competitors IBM and Fujitsu. In that case, the arbitrators ultimately ordered IBM to provide its operating-system source code and other secret information to Fujitsu and ordered *Fujitsu* to pay significant money to IBM for the privilege. See David E. Sanger, Fight Ends For I.B.M. And Fujitsu, NY Times, Sept. 16, 1987. For more background on that dispute, see a student note from the 1980s by Anita Stork (now a prominent antitrust litigator), The Use of Arbitration in Copyright Disputes: IBM v. Fujitsu, 3 Berkeley Tech. L.J. 241 (1988).

See also the commentary about limited appealability of arbitration awards, at [NONE].

#### *22.7.17.3 Subdivisions b and c: Conformity to law and contract*

Absent language such as that of these subdivisions, an arbitrator might be able to ignore a statute of limitations that would otherwise bar a claim — and compounding the concern, arbitration awards cannot be appealed except on very-limited grounds

(in some jurisdictions the parties can agree otherwise), as discussed the commentary to Option 22.7.23.

See generally Liz Kramer, Don't Find Yourself SOL: Know Whether the Statute of Limitations Applies to Your Arbitration (ArbitrationNation.com 2016).

### 22.7.18 Attorney fees for failed arbitration challenge

a. IF: A party (a "challenging party") goes to court to try: (i) to get out of arbitration, and/or (ii) to set aside an arbitration award (each, an "arbitrability challenge");

AND: The arbitrability challenge fails;

THEN: The challenging party must reimburse the other party for its attorney fees (see the definition in Clause 22.16) incurred in connection with the failed arbitrability challenge,

in both trial- and appellate courts.

b. The court, not the arbitral tribunal, is to determine the amount of the reimbursement.

*Commentary*

At almost any point in an arbitration, a party desiring to delay the proceedings might go to court to challenge the propriety of the arbitration. This section tries to discourage such stalling tactics by imposing attorney-fee sanctions for unsuccessful stalling attempts, as suggested by an experienced arbitrator.

See Gary McGowan, *12 Ways to Achieve Efficiency and Speed in Arbitration* § 2, Corporate Counsel (Apr. 22, 2013) (no longer available online).

Subdivision b is an exception to the delegation of arbitrability decisions to the arbitral tribunal in [NONE].

### 22.7.19 WAIVER OF JURY TRIAL

Each party WAIVES (see the definition in Clause 22.162) any right it might have to trial by jury for any dispute that the Contract requires to be arbitrated.

*Commentary*

This waiver of the right to a jury trial is probably overkill for most jurisdictions, but it's one of those instances where a few extra words could be cheap insurance against future disputes raised by "creative" litigation counsel.

Normally, advance waivers of jury trials are unenforceable in California and Georgia, as explained in the commentary to [NONE] — but those state laws likely would be preempted in cases where the Federal Arbitration Act applied.

See generally, e.g., AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 131 S. Ct. 1740 (2011) (FAA preempts state law barring enforcement of waiver of class arbitration).

*Contra:* The New Jersey supreme court held that an arbitration provision was unenforceable because the provision did not expressly waive jury trial; to the surprise of many observers, the Supreme Court declined to hear the losing side's appeal.

See Atalese v. US Legal Serv. Group, LLP, 219 N.J. 430 99 A.3d 306 (2014).

On the other hand, the Nevada supreme court held that a state statute imposing requirements on arbitration agreements was indeed preempted.

See MMAWC, LLC v. Zion Wood Obi Wan Trust, 135 Nev. Adv. Op. 38, 448 P.3d 568 (2019).

### 22.7.20 Survival of arbitration provisions

Even if the Contract comes to an end in some way (whether by termination or expiration), the provisions of the Contract relating to arbitration will still remain in effect.

*Commentary*

This section is a precautionary measure to forestall contrary arguments.

### 22.7.21 Required notice of an *enforcement* action

IF: A party files an action, in any forum, seeking to confirm or enforce an arbitration award, or to vacate an award in whole or in part,

THEN: That party must promptly cause notice to be given to the other party,

in the arbitral language (see the definition in Clause 22.7.11),

that the action has been filed.

(An actually-received or -refused written notification, in the arbitral language, from an arbitration administrator (see the definition in Clause 22.7.9), will suffice for this purpose.)

*Commentary*

This particular notice requirement seeks to avoid trouble analogous to the situation in which a U.S. retailer found itself.

The U.S. retailer had entered into a contract with a Chinese manufacturer. The retailer received notice that the manufacturer had demanded arbitration. *The notice was written in Chinese*, and the manufacturer didn't get the notice translated for a while, which led to the Chinese arbitration tribunal entering an award against the manufacturer. (The American courts refused to enforce the award on grounds that the notice was not reasonably calculated to apprise the retailer of the proceedings. See CEEG (Shanghai) Solar Science & Tech. Co. v. LUMOS LLC, 829 F.3d 1201, 1207 (10th Cir. 2016), *affirming* No. 14-cv-03118 (D. Colo. May 29, 2015).)

### 22.7.22 Attorney fees for failure to comply with award

IF: A party is required to take action under an arbitration award;

BUT: That party does not timely comply with the requirement on its own,

and another party successfully goes to court or other forum to confirm and/or enforce the requirement;

THEN: *As damages for the noncompliance*, the noncompliant party must pay or reimburse the other party's reasonable attorney fees (see the definition in Clause 22.16) for those confirmation and/or enforcement proceedings —

at all stages of the confirmation- and/or enforcement proceedings, at both trial- and appellate levels; and

in addition to any other relief granted to the successful party, either in the confirmation / enforcement proceedings or in the arbitration.

*Commentary*

#### *22.7.22.1 A "one way" prevailing-party rule*

This section seeks to avoid what likely would happen under the "American Rule" (see the commentary to [NONE]) for attorney fees: A party that won an arbitration case, but then had to go to court to enforce the award, might well be denied attorney fees for the court proceedings.

See Diathegen, LLC v. Phyton Biotech, Inc., No. 04-14-00267-CV (Tex. App.—San Antonio Aug. 26, 2015, pet. denied).

On a related note: Also invoking the American Rule, the Second Circuit held that, when the parties' contract provides only for awarding attorney fees *for breach* of the contract, such fees cannot be awarded to a respondent that successfully *defended* against a claim of breach in arbitration and then successfully defended against the claimant's attempt to vacate the award in court. See Zurich American Insurance Co. v. Team Tankers A.S., 811 F.3d 584 (2d Cir. 2016).

(The *Zurich American* ruling is of a piece with the "Texas rule" (see Section 22.16.1.4: ) concerning attorney fees, which is largely to the same effect.)

Compare Westgate Resorts, Ltd. v. Adel, 2016 UT 24, 378 P.3d 93 (2016), where the Utah supreme court affirmed that the state's arbitration statute did not authorize *the arbitration panel* to award fees (in advance) for post-arbitration judicial enforcement of award. *Id.* ¶ 16, 378 P.3d at 95. The supreme court noted that the parties had not briefed the question whether *the district court* could have awarded such fees, and so the supreme court did not address that question. *See id.* at 93 n.1.

### 22.7.23 Option: Enhanced Right of Appeal

a. *Specific agreement required:* This Option is part of the Contract only if unambiguously agreed.

b. *Limit on arbitrator power:* Under this Option, the arbitral tribunal's powers do not include the power to render an award that:

1. is based on errors of law or legal reasoning that would be grounds for reversal if made by a judge in a civil trial to the court (sometimes known as a "bench trial"); or

2. is based on evidence that would not satisfy the requirements of law in such a trial; or

3. grants relief prohibited by the Contract or not available under applicable law.

c. *Enhanced appeal right:* IF: A court of competent jurisdiction finds that an arbitration award is based, in whole or in part, on one or more of the factors enumerated in subdivision b of this Option;

THEN: The parties desire that, upon application of either party, the award is to be vacated, on grounds that (without limitation) the arbitral tribunal thereby exceeded its agreed powers.

d. *California law to apply:* The interpretation and enforcement of this Option is to be governed by the law of the State of California applicable to contracts made and performed entirely in, by residents of, that state.

e. ☐ *Jettison:* (OPT-IN REQUIRED) IF: This Option is found to be unenforceable; AND: The parties have agreed to jettison this Option in such event; THEN: The parties' agreement to arbitrate may be rescinded; all as provided in Option 22.7.24.

*Commentary*

*22.7.23.1 Hall Street: Federal law restricts arbitration appeals*

In its *Hall Street* case, the (U.S.) Supreme Court held that, when the sole authority for an arbitration proceeding is the Federal Arbitration Act, the courts may not entertain an appeal of the award except on the limited, misconduct-based grounds provided in section 10 of that statute.

See Hall Street Associates, L.L.C. v. Mattel, Inc., 552 U.S. 576, 128 S. Ct. 1396 (2008).

In a later case, the Court later explained:

> *Because the parties bargained for the arbitrator's construction of their agreement, an arbitral decision even arguably construing or applying the contract must stand, regardless of a court's view of its (de)merits*.
>
> Only if the arbitrator acts outside the scope of his contractually delegated authority — issuing an award that simply reflects his own notions of economic justice rather than drawing its essence from the contract — may a court overturn his determination.
>
> So the sole question for us is whether the arbitrator (even arguably) interpreted the parties' contract, not whether he got its meaning right or wrong.

Oxford Health Plans LLC v. Sutter, 569 U.S. 564, 133 S. Ct. 2064, 2068 (2013) (cleaned up, citations omitted, emphasis and extra paragraphing added).

#### *22.7.23.2 Enhanced judicial review under state law?*

Drafters can keep in mind another possibility for enhanced appellate review: In its *Hall Street* decision, the Court expressly left open the possibility that enhanced review might be available under some other authority, such as state law or (in the case of court-annexed arbitrations) a court's inherent power to manage its docket.

See *Hall Street*, part IV, 128 S. Ct. at 1406-07.

• Subsequently, both the California and Texas supreme courts ruled that, in proceedings under the arbitration acts of their respective states, the parties were free to agree to enhanced judicial review.

See Cable Connection, Inc. v. DIRECTV, Inc., 44 Cal.4th 1334, 82 Cal. Rptr.3d 229, 190 P.3d 586 (2008) (reversing and remanding reversal of district court's *vacating* of arbitration award); Nafta Traders, Inc. v. Quinn, 339 S.W.3d 84 (Tex. 2011) (reversing and remanding *confirmation* of arbitration award that failed to address losing party's allegation that arbitrator did not comply with law as required by arbitration agreement).

• In contrast, the Tennessee supreme court reached the opposite conclusion; the court held that the arbitration agreement's expansion of the scope of judicial review was invalid.

See Pugh's Lawn Landscape Co. v. Jaycon Dev. Corp., 320 S.W.3d 252 (Tenn. 2010) (vacating judgment confirming arbitrator's award).

• By statute, New Jersey law provides that "nothing in this act shall preclude the parties from expanding the scope of judicial review of an *[arbitration]* award by expressly providing for such expansion in a record."

N.J. Stat. Ann. § 2A:23B-4(c); *see also* Hogoboom v. Hogoboom, 924 A.2d 602, 606, 393 N.J. Super. 509 (App. Div. 2007) (explaining history of expanded-review statute, and holding that initial review must be by trial court, not appellate court). (Hat tip: arbitrator Laura Kaster.)

#### *22.7.23.3 An express state-law reference might be needed*

Parties desiring enhanced review should seriously consider specifying that the arbitral law is that of a jurisdiction that permits such review. In one Fifth Circuit case, a party lost an arbitration, and on appeal the losing party cleimed that the arbitration panel had "completely botched" certain issues. The appellate court held that under the Supreme Court's Oxford Health Plans decision, the losing party was stuck with the arbitration panel's interpretation of the relevant contract, even if that interpretation was arguably incorrect. The court explained: "Because the Agreement does not refer to [state law], or any other body of law offering a competing standard of review, we hold that the FAA's standard of review controls."

BNSF R.R. Co. v. Alston Transp., Inc., 777 F.3d 785, 790-91 (5th Cir. 2015) (vacating district court's vacatur of arbitration award and remanding with instructions to reinstate award; citations omitted, emphasis and extra paragraphing added), *citing* Action Indus., Inc. v. U.S. Fid. & Guar. Co., 358 F.3d 337, 341 (5th Cir. 2004).

#### *22.7.23.4 Subdivision b: Limit on arbitrator power*

The language, "has the power only to award such relief," has in mind that, under the (U.S.) Federal Arbitration Act, one of the very few grounds allowing a federal court to vacate an arbitration award is that "the arbitrators exceeded their powers …."

9 U.S.C. § 10(a)(4).

#### *22.7.23.5 Subdivision d: Choice of California law*

In California and some other states, the law expressly allows appeal from an arbitration award if the parties so agree; see the commentary at Section 22.7.23.2: . This section explicitly adopts California law because enhanced review might require an *express* reference to a congenial arbitral law, as discussed above.

Concerning choosing different governing laws for different purposes, see the discussion in the commentary at [NONE].

#### *22.7.23.6 Subdivision e: Jettison of arbitration?*

When drafting an arbitration provision with an agreement to enhanced judicial review, consider whether to use Option 22.7.24 to provide that the arbitration provision is to be "jettisoned" if a reviewing court declines to provide an enhanced review.

### 22.7.24 Option: Jettison of Arbitration Agreement

a. *Specific agreement required:* This Option is part of the Contract only if unambiguously agreed.

b. *Prerequisites:* If this Option is agreed to, it applies if the following prerequisites are satisfied:

1. the parties have agreed in writing that a particular provision of their agreement to arbitrate is subject to this Option; and

2. a court of competent jurisdiction holds that the particular provision is unenforceable; such a holding must be in a final judgment from which no further appeal is taken or possible (a "*Final-Final*" judgment).

c. *Rescission option:* Either party may, by notice to the other party and to the court, unilaterally rescind the parties' arbitration agreement and thereby automatically vacate any arbitration award.

d. *Rescission deadline:* The notice of rescission must be effective no later than five court days (i.e., days on which the court is open for routine business) after the judgment becomes Final-Final, as defined above.

e. *Tolling:* If a party exercises this rescission right, then any applicable statute of limitation or -repose is to be deemed to have been retroactively tolled beginning with the date on which the demand for arbitration was made and ending five court days after the effective date of the notice of rescission.

*Commentary*

In some cases, a party might regard a particular agreed feature of arbitration — for example, an enhanced right of appeal, see [NONE]) — as being so important that the party isn't willing to agree to arbitration without that feature. For that situation, this Option can be included in the Contract.

This Option is informed by a case in which Tennessee's supreme court held that an agreement to arbitrate in a contract must be judicially rescinded for mutual mistake, in view of that court's holding that the parties' agreement to expanded judicial review was invalid.

See Pugh's Lawn Landscape Co. v. Jaycon Dev. Corp., 320 S.W.3d 252 (Tenn. 2010).

### 22.7.25 Option: Severability of Arbitration Provisions

a. *Specific agreement required:* This Option is part of the Contract only if unambiguously agreed.

b. *Applicability:* This Option will apply automatically — except as provided in Tango Clause 22.7.24 - Option: Jettison of Arbitration Agreement — if the following prerequisites are satisfied:

1. the Contract clearly states, in substance, that some or all of the parties' agreement to arbitrate is severable; and

2. a court of competent jurisdiction determines, in a decision from which no further appeal is taken or possible, that one or more provisions of the parties' agreement to arbitrate is void, invalid, or otherwise unenforceable for any reason.

c. *Severance request:* In any such case, the parties desire that the unenforceable provision be severed from the remainder of the agreement to arbitrate, while the remainder of the agreement to arbitrate is to be enforced.

### 22.7.26 Option: Prohibition of Punitive *Sanctions*

a. *Specific agreement required:* This Option is part of the Contract only if unambiguously agreed.

b. *Prohibited arbitrator actions:* The arbitral tribunal will have no power to order punitive sanctions against a party, in respect of an issue (or multiple issues), in the form of:

1. preclusion of evidence or defense concerning the issue, or

2. entry of judgment concerning the issue.

*Commentary*

This optional language seeks to avoid the result in a case where a disk-drive manafacturer sued a defecting employee and his new employer for theft of trade secrets.

The arbitrator found that the defecting employee had fabricated evidence and that the new employer was complicit in the fabrication. *As a punitive sanction*, the arbitrator:

1. barred the defecting employee and the new employer from contesting the manufacturer's position about the validity and misappropriation of the trade secrets in question, and

2. based on *the former employer's* evidence, awarded the disk-drive manufacturer more than **$600 million**. See Seagate Technology, LLC v. Western Digital Corp., 854 N.W.2d 750, 760 n.7 (Minn. 2014) (with extensive citations).

### 22.7.27 Option: Prohibition of Punitive *Damages*

a. *Specific agreement required:* This Option is part of the Contract only if unambiguously agreed.

b. *Prohibited arbitrator actions:* The arbitral tribunal will have no power to award punitive damages, exemplary damages, multiple (e.g., treble) damages, or similar relief.

*Commentary*

Portions of this prohibition are adapted from a provision at issue in another Eighth Circuit case.

See Wells Fargo Bank, N.A. v. WMR e-PIN, LLC, 653 F.3d 702 (8th Cir. 2011) (affirming confirmation of award, albeit for procedural reasons).

Subdivision b: This prohibition is phrased *without* the qualifier, "to the maximum extent permitted by law"; otherwise, the prohibition might be disregarded, as happened in an Eighth Circuit case.

See Stark v. Sandberg, Phoenix & von Gontard, P.C., 381 F.3d 793 (8th Cir. 2004).

If more detail is desired in spelling out remedies that the arbitral tribunal is *not* permitted to award, see the examples provided in a construction-law article.

See Charles M. Sink, Negotiating Dispute Clauses That Affect Damage Recovery in Arbitration, The Construction Lawyer, vol. 22, no. 3, summer 2002.

## Clause 22.8 Archive Copies

### 22.8.1 Applicability

This Clause applies if and when the Contract:

1. requires a specified party, referred to here as "*Retainer*," (i) to return documents or other materials (collectively, "documents") to another party ("*Owner*") or (ii) to destroy the documents; BUT

2. allows Retainer to retain archive copies (or "archival copies") of the documents.

*Commentary*

This Clause is perhaps most likey to be used when the Contract requires information to be purged, such as in Tango Clause 22.81 - Information Purges.

### 22.8.2 Permissible custodian(s) of archive copies

As a safe harbor, one possible (and non-exclusive) way for Retainer to comply with [NONE] would be for Retainer to maintain the archive copies in the custody of a reputable commercial storage organization,

> as long as that organization was contractually obligated to securely maintain the copies in confidence.

*Commentary*

Alternatives:

> Retainer must use an outside organization to maintain the archive copies; the outside organization must meet the requirements of the safe-harbor option of this section.

or:

> Retainer must maintain all archive copies itself, without using an outside organization.

### 22.8.3 Permissible location(s) for archive copies

Archive copies may be kept in one or more locations reasonably chosen by Retainer.

### 22.8.4 Number of archive copies

Retainer may cause a reasonable number of archive copies (including but not limited to backup copies) to be maintained.

### 22.8.5 Retention duration

Archive copies may be retained indefinitely — but all such retention is subject to the requirements of this Clause.

### 22.8.6 Security requirements for archive copies

Retainer must cause at least prudent measures to be taken to maintain the security of archive copies.

*Commentary*

For especially-sensitive information, an Owner might want to require specific security precautions.

### 22.8.7 Confidentiality obligations for archive copies

Retainer must comply with Tango Clause 22.34 - Confidential Information for any information in archive copies that qualifies as Confidential Information of Owner.

*Alternative*

Retainer need not maintain the archive copies or their contents in secrecy.

### 22.8.8 What may be retained

Unless the Contract clearly states otherwise, Retainer may cause archive copies to be made and/or retained of the following (without limitation):

electronic documents;

photographs and video / audio-visual recordings;

including, without limitation, those made to document tangible objects and/or events; and

sound recordings of audible events.

*Alternative*

Retainer may cause archive copies to be made, and/or retained, of the following items only: *[DESCRIBE]*.

### 22.8.9 Permissible access to archive copies

Retainer must take prudent measures to ensure that archive copies are not made accessible to anyone, *except* from time to time in one or more of the following ways:

1. by Retainer's personnel who maintain the archive copies (if applicable);
2. as agreed in writing by Owner;
3. as directed (or permitted) by a legal tribunal having jurisdiction; and/or
4. in response to a compulsory legal demand, as provided in [NONE].

### 22.8.10 Permissible use of archive copies

Retainer must not use archive copies, nor allow or knowingly assist in such use by others, *except*, from time to time, for one or more of the following purposes:

1. determining, and confirming Retainer's compliance with, Retainer's continuing obligations under the Contract;
2. documenting the parties' past- and present interactions relating to the Contract;
3. reasonable testing of the accuracy of the archive copies;
4. and/or as otherwise agreed in writing.

## Clause 22.9 As-Is Disclaimer Definition

a. For purposes of this Definition, the term "*Factual Commitment*" refers to any of:

1. a warranty (see the definition in Clause 22.163);
2. a representation (see the definition in Clause 22.134); and/or
3. a condition or term of quality.

b. The term *as-is* — whether or not capitalized — operates as a disclaimer of all Factual Commitments concerning *performance* and *non-infringement*.

c. An as-is disclaimer negates, without limitation, any *implied* Factual Commitment that might otherwise apply concerning *merchantability* or fitness for a particular purpose.

d. An as-is disclaimer does **not** negate:

1. any *express* Factual Commitment; nor
2. any Factual Commitment that might be implied under applicable law concerning *title* to goods.

e. An as-is disclaimer may be expressed in variations such as "as is, where is, with all faults," which will have the same meaning as stated in this Definition.

*Commentary*

This definition is modeled on § 2-316 of the (U.S.) Uniform Commercial Code, which covers disclaimer of implied warranties in sales of goods. It's included here in case the UCC doesn't apply (for example, if this Agreement is not for the sale of goods or if the transaction is governed by a law that doesn't include some version of the UCC).

One common formulation for disclaiming warranties is "AS IS, *[and sometimes: WHERE IS,]* WITH ALL FAULTS," in all-cap, bold-faced type, or other conspicuous manner.

**Caution:** Drafters should check for any applicable legal requirement of conspicuousness for warranty disclaimers.

**Caution:** The definition does *not* exclude implied warranties of *title*. This carve-out is modeled on UCC § 2-312, which requires that a disclaimer of an implied warranty of title must be expressly stated. From a business perspective this makes sense, of

course; as an example, even if Alice were to sell Bob a car "as is," Bob should still be entitled to assume that Alice isn't trying to sell him stolen property.

## Clause 22.10 Assignment - Assignee Assumption

a. Any assignee of the Contract must agree in writing to abide by the assigning party's obligations the Contract,

> including but not limited to any covenants concerning confidentiality and/or noncompetition,
>
> and deliver the agreement to the other party;
>
> the assignment will be void until the assignee does so.

b. In case of doubt: this Clause in itself neither authorizes nor prohibits assignment of the Contract.

*Commentary*

This policy seeks to avoid the result in a Florida federal case: A franchisor terminated a franchise agreement but was unable to enforce a contractual noncompetition covenant against the franchisee, because:

- the franchisee was not the original franchisee that had signed the contract containing the noncompetition covenant, but instead was the successor in interest to the original franchisee;
- under a Florida statute, a noncompetition covenant could not be enforced against a party that did not sign the writing containing the covenant; and
- the *successor* franchisee had not signed the franchise agreement.

> See Interim Healthcare, Inc. v. Interim Healthcare of Se. Louisiana, Inc., No. 19-CV-62412, slip op. at part III.B.2.a (S.D. Fla. June 10, 2020), *citing* Fla. Stat. § 542.335(1)(a).

# Clause 22.11 Assignment Consent

## 22.11.1 Applicability; parties

The parties are to follow this Clause when, under the Contract, one party ("*Reviewer*") has the right to consent to assignment of an agreement by another party ("*Assignor*") to a third party ("*successor*").

*Commentary*

### *22.11.1.1 Legal background 1: What is an "assignment"?*

Some contracts require that, if a party wishes to assign the contract, then the would-be assigning party must first obtain the consent of another pary to the contract. This Clause provides ground rules for the seeking, and the withholding, of such consent.

Generally speaking, to "assign" a contract is to **transfer** the assigning party's rights, AND to **delegate** that party's obligations, to another party.

The legal implications of an assignment can be important — particularly concerning provisions such as indemnity- and defense obligations if a catastrophic event occurs, such as an oil-well blowout, because the parties and/or their successors might fiercely dispute whether those obligations applied to a successor.

> See, e.g., the contract diagram in Certain Underwriters at Lloyd's, London v. Axon Pressure Prods. Inc., 951 F.3d 248 (5th Cir. 2020), in the aftermath of an oil-well blowout in the Gulf of Mexico.

### *22.11.1.2 Legal background 2: Free assignability of (most) contracts*

Normally, in U.S. law, most contracts (but not all) can be freely assigned, with the assigning party's duties delegated to the third party, without the consent of the other party; this general rule is thought to promote economic efficiency.

BUT: **Three** categories of contract are exceptions to this general rule of free assignability:

a. **Intellectual-property license agreements** are not assignable **by the licensee** without the consent of the owner of the intellectual property in question (the *licensor* is presumably free to assign if it wishes).

> See, e.g. In re XMH Corp., 647 F.3d 690 (7th Cir. 2011) (Posner, J.) (trademark licenses); Cincom Sys., Inc. v. Novelis Corp., 581 F.3d 431 (6th Cir. 2009) (copyright licenses); Rhone-Poulenc Agro, S.A. v. DeKalb Genetics Corp., 284 F.3d 1323 (Fed. Cir. 2002) (patent licenses).

b. A party may not assign a contract if the assigning party's performance is considered **special or unique**.

For example, suppose that Kanye West were under contract with the organizers of a hip-hop festival to perform at the festival: West probably couldn't assign his performance contract to, say, hard-rocker Ted Nugent without the consent of the festival organizers.

(**Caution:** For any given contract, the question whether a particular party's performance would fall into this category would probably present **factual issues** that would have to go to **trial**, as opposed to being adjudicated more quickly and less expensively on the pleadings or on summary judgment.)

As another example, an executive who signs an executive employment agreement might find it hard to convince a court that the executive should be able to assign the agreement to a replacement exective.

c. A party may not assign a contract **if the contract prohibits** assignment.

#### *22.11.1.3 Caution: Strategic danger*

In a *long-term* contractual relationship, a party's desire to require consent to assignment by the other party can be strategically dangerous for the other party. Contracts are frequently assigned in connection with corporate mergers, acquisitions, and spin-offs. This means that:

- Assignor might someday want to assign the Contract in connection with, say, a spinoff or divestiture of an unincorporated division, a product line, etc.;
- Reviewer's right to consent to such an assignment could give Reviewer a veto over the broader transaction and, thus, potentially-material leverage over Assignor's business choices.

(See the asset-transfer exception in [NONE] for one possible way of dealing with this danger.)

### 22.11.2 Reviewer's objection deadline

a. Within ten business days after Reviewer receives Assignor's written request for consent to a proposed assignment, Reviewer must advise Assignor in writing whether Reviewer consents to the assignment, EXCEPT as stated in subdivision b below.

b. IF: Reviewer reasonably requests more information about the proposed successor,

> THEN: The clock will be stopped on Reviewer's time to respond under subdivision a until such time, if any, as Reviewer obtains the requested information, whether from Assignor or from one or more other sources.

c. IF: Reviewer does not object to a request for consent to assignment within the time specified in subdivision a (possibly as extended per subdivision b);

THEN: Reviewer will be deemed to have consented to Assignor's request.

*Commentary*

If Reviewer were to take too long to respond to a request for consent to assignment, the delay could seriously hinder or even torpedo the associated transaction that Assignor is contemplating — but, in evaluating a request by Assignor for consent to assignment of the Contract, Reviewer might feel that it doesn't know enough about Assignor's prospective successor. This section offers a compromise between these two competing interests.

Subdivision c is intended to deprive Reviewer of the ability to disrupt Assignor's proposed transaction — Reviewer could try to do so by stonewalling Assignor's request for consent to assignment, perhaps to to try to ~~extort~~ extract concessions from Assignor.

### 22.11.3 Reporting of reasons for refusing consent

a. IF: Reviewer refuses consent to a proposed assignment; THEN: Reviewer must also, no later than one business day later, provide Assignor with a written explanation, in reasonable detail, of all of Reviewer's then-existing reasons for withholding consent.

b. Reviewer's providing of a statement of reasons under subdivision a will not preclude Reviewer from later citing other facts to support its withholding of consent.

c. This section is not intended, in itself, to impose any standard by which Reviewer must grant or withhold consent.

*Commentary*

This section merely requires Reviewer to act as a good "business partner" would, so that Assignor won't be left dangling about whether Reviewer's consent to assignment will or won't be forthcoming.

### 22.11.4 Options: Standard for withholding consent

None of the following options will apply except to the extent, if any, that the Contract unambiguously says otherwise; blank ballot boxes ☐ below, if any, are intended to signal this visually.

a. ☐ Reviewer may withhold consent to assignment in its sole discretion (see the definition in Clause 22.49).

b. ☐ Reviewer may not arbitrarily or capriciously withhold, delay, or condition consent to assignment.

c. ☐ Reviewer may not unreasonably withhold, delay, or condition consent tno assignment.

d. ☐ The Contract may identify specific factors that would permit Reviewer to withhold consent to assignment.

e. ☐ Reviewer is to take into account any evidence that Assignor timely provides concerning the relevant qualifications, capabilities, and financial position of Assignor's proposed successor.

f. ☐ A requirement that Assignor pay a fee (no matter how named) in addition to any fee or other payment that may be due under this Agreement, as a prerequisite to consent to assignment, is to be considered an unreasonable and arbitrary condition to consent.

*Commentary*

*22.11.4.1 Purpose*

The above language gives drafters tools with which to impose limits on Reviewer's ability to withhold consent to assignment.

Subdivision e lays out factors that Reviewer may — or must — consider, as suggested in an article by two noted scholars.

> See Robert E. Scott and George G. Triantis, Anticipating Litigation in Contract Design, 115 Yale L.J. 814, 872-73, text accompanying n.178 (2006), archived at https://perma.cc/R46W-H5JA.

As one example of such factors, a commenter notes that "[a] more aggressive landlord will expressly condition its consent *[to a tenant's assignment of a lease]* on the presence or absence of certain circumstances, such as: (1) the tenant not being in default under the lease …."

> Katherine Medianik, Permitted Transferees: What a Commercial Tenant Needs to Know When Negotiating the Assignment Clause (JDSupra.com 2020), https://perma.cc/SC5U-RSB8 (items 2 through 7 omitted).

*22.11.4.2 The law might bar unreasonable withholding of consent*

in some jurisidictions the law might require that consent to assignment of the agreement must not be unreasonably withheld.

Examples:

- Section 1995.260 of the California Civil Code provides that: "If a restriction on transfer of **the tenant's interest in a lease** requires the landlord's consent for transfer but provides no standard for giving or withholding consent, the restriction

on transfer shall be construed to include an implied standard that the landlord's consent may not be unreasonably withheld. … "

Apropos of that statutory provision, a California appeals court held in 2008 that a contract provision allowing the landlord to withhold consent "for any reason or no reason" was not to be construed as including an unreasonably-withheld standard, saying that "the parties' express agreement to a 'sole discretion' standard is permitted under legal standards existing before and after enactment of section 1995.260, as long as the provision is freely negotiated and not illegal." Nevada Atlantic Corp. v. Wrec Lido Venture, LLC, No. G039825 (Cal. App. Dec. 8, 2008) (unpublished; reversing trial-court judgment that withholding of consent was unreasonable).

- In an Oregon case, a lease prohibited the tenant from assigning the agreement, including by operation of law, without the landlord's consent. The lease also stated that the landlord would not unreasonably withhold its consent to an assignment of the lease *to a subtenant that met certain qualifications*. Notably, though, the lease did not include a similar statement for *other* assignments. The Oregon supreme court held that ordinarily, the state's law would have required the landlord to act in good faith in deciding whether or not to consent to an assignment. But, the court said, the parties had implicitly agreed otherwise; therefore, the landlord did *not* have such a duty of good faith.

  See Pacific First Bank v. New Morgan Park Corp., 876 P.2d 761 (Or. 1994) (affirming court of appeals decision on different grounds, and reversing trial-court declaration that bank-tenant had not *materially* breached lease).

- In a factually-messy Eleventh Circuit case, the court upheld a trial court's finding that the owner of a patent, which had exclusively licensed the patent to another party, had not acted unreasonably when it refused consent to an assignment by the licensee to a party that wanted to acquire the licensee's relevant product line.

  See MDS (Canada) Inc. v. Rad Source Tech., Inc., 720 F.3d 833, 850 (11th Cir. July 1, 2013) (affirming district court's judgment in part and certifying question of sublicense-as-assignment to Florida supreme court).

- The Tennessee supreme court held that "where the parties have contracted to allow assignment of an agreement with the consent of the non-assigning party, and the agreement is silent regarding the anticipated standard of conduct in withholding consent, an implied covenant of good faith and fair dealing applies and requires the nonassigning party to act with good faith and in a commercially reasonable manner in deciding whether to consent to the assignment."

  Dick Broadcasting Co. v. Oak Ridge FM, Inc., 395 S.W.3d 653, 656-57 (Tenn. 2013) (affirming vacation of summary judgment and remand to district court).

- Likewise, the Alabama supreme court alluded to such a possibility: The contract in suit specifically gave the Shoney's restauraunt chain the right, *in its sole discretion*, to consent to any proposed assignment or sublease of a ground lease by a real-estate developer that had acquired the ground lease from Shoney's. The supreme court held that this express language trumped a rule that had been laid down in prior case law, namely that a refusal to consent is to be judged by a reasonableness standard under an implied covenant of good faith.

See Shoney's LLC v. MAC East, LLC, 27 So.3d 1216, 1220-21 (Ala. 2009) (on certification by Eleventh Circuit).

BUT: *The reviewing party might be willing to "play chicken"* with the assigning party by (metaphorically) folding its arms and saying, in effect: *We think we're being reasonable in withholding our consent unless you pay us big bucks. If you don't agree, then sue us — and watch your deal disappear while you wait months or years for the court proceedings to end.* (That's why [NONE] imposes a deadline for refusing consent.)

#### *22.11.4.3 Special case: Oil and gas leases in Texas*

Oil and gas "leases" under Texas law are a different breed, "chimeras of *contract* and *property* law … [and] 'leases' in name only," with a heavy presumption in favor of the right to assign.

See Mayo Foundation for Medical & Educ. Research v. BP America Prod. Co., 447 F. Supp. 3d 522, 529, 532-33 (N.D. Tex. 2020) (reviewing case law) (emphasis added). Citing various commentators, the *Mayo Foundation* court listed seven specific factors that it considered in deciding whether withholding of assignment consent had been reasonable. The court denied a motion for a preliminary injunction against assignment of a lease, on grounds that the plaintiff had not shown that it had *reasonably* withheld its consent to the assignment as required by a provision in the lease.

### 22.11.5 Consent exception: Pledges of payment rights

a. Except as stated in this section, Assignor need not obtain Reviewer's consent to any "Pledge," as defined in subdivision b below, whether the Pledge is absolute or collateral.

b. In this context, the term "*Pledge*" refers to an assignment, pledge, or grant of a security interest that does *not*:

1. purport to delegate any of Assignor's material obligations under the Contract, nor

2. have such an effect as a matter of law.

*Commentary*

To preserve its financial flexibility, Assignor will want to retain its ability to make a Pledge of some or all of its right to payment under the Contract — for example, pledging future payments to a lender as collateral for a loan.

Even without the carve-out of this section, courts have distinguished between assigning an *agreement* in its entirety and assigning certain *rights and benefits* under the agreement. For example, the Oklahoma supreme court has held: "We agree with a majority of courts stating an insured's post-loss assignment of a property insur-

ance claim is an assignment of a chose in action and not an assignment of the insured's policy."

Johnson v. CSAA Gen. Ins. Co., 2020 OK 110 ¶ 1 (Okla. 2020).

### 22.11.6 Consent exception: Certain asset transfers

Unless the Contract umambiguously states otherwise, Assignor need not obtain Reviewer's consent to an assignment of the Contract that occurs in conjunction with a sale or other transfer of substantially all of the assets of Assignor's business to which the Contract relates.

*Commentary*

#### *22.11.6.1 Business context*

Suppose that Alice and Bob are negotiating a contract between them. It'd be fairly standard for Bob to want to be able to assign the contract *without* Alice's consent if Bob were to do an asset disposition such as the sale of an unincorporated division or a specific product line. This could be crucial to Bob's company if the company wanted to retain control over its own strategic destiny.

Moreover, if Bob were to sell a line of business, an assignment-consent exception for asset sales also could save Bob's assignee ("Betty") from having to re-buy and pay again for an IP license that Bob already paid for once for the line of business.

Something close to this happened in a Sixth Circuit case in which a software customer found itself having to pay copyright-infringement damages to a software vendor, in an amount equal to the licensee fee that the customer had already paid, because the customer switched the use of the software to an unauthorized affiliate. See Cincom Sys., Inc. v. Novelis Corp., 581 F.3d 431 (6th Cir. 2009) (affirming summary judgment in favor of software vendor); cf. [NONE] (late payment does not constitute infringement).

So in Alice and Bob's contract negotiation, Bob might argue for one or more consent carve-outs along the following lines: *We need to keep control of our strategic destiny. If we ever wanted to sell a product line or a division (or even the whole company) in an asset sale, we'd need to be able to assign this agreement as part of the deal. We don't want to have to worry about whether somebody at your company was going to get greedy and try to hold us up for a consent fee.*

Alice, though, might respond in the negotiation with something like this: *Wait — what if you decided to sell a product line or a division to one of our competitors? We need to retain control over that possibility. The only way for us to do that is to retain the absolute right to consent to any assignment you might make.*

Who "wins" this negotiation will often be a matter of which party has the stronger bargaining position.

#### *22.11.6.2 Alternatives*

This section allows consent-free assignments with assets of *Assignor's line of business*, but some prospective Reviewers might prefer a narrower exception:

> Assignor need not obtain Reviewer's consent to an assignment of the Contract that occurs in conjunction with a sale or other transfer of substantially all of the assets *of Assignor's business*.

(Emphasis added.) And some Reviewers might prefer to eliminate the exception altogether:

> Reviewer's consent is required even for an assignment of the Contract in conjunction with a sale or other transfer of Assignor business assets

### 22.11.7 Consent exception: Mergers

a. Unless the Contract specifically and unambiguously provides otherwise, a "Merger Transaction" (defined in subdivision b) on Assignor's part does not require Reviewer's consent.

b. For this purpose, the term "*Merger Transaction*" refers to —

> a merger, consolidation, amalgamation, or other similar transaction or series of transactions, involving Assignor,
>
> in which, for any reason, Assignor is not the surviving entity.

*Commentary*

#### *22.11.7.1 Background*

Background: In some jurisdictions, a merger or similar transaction *automatically* results in an assignment of assets by operation of law **if** the assigning party is not the "surviving entity." This means that a merger or other transaction might require Reviewer's consent, giving Reviewer leverage over Assignor's strategic options.

#### *22.11.7.2 It might matter which is the "surviving entity"*

The Delaware chancery court once ruled, on summary judgment, that "mergers *do not* result in an assignment by operation of law of assets *that began* as property of the surviving entity *and continued to be such after the merger*."

> Meso Scale Diagnostics, LLC v. Roche Diagnostics GmbH, 62 A.3d 62 (Del. Ch. 2013) (partial summary judgment) (emphasis added).

*Accord*: Florey Inst. of Neuroscience & Mental Health v. Kleiner Perkins Caufield & Byers, No. CV 12-6504 SC, slip op. part IV.B (N.D. Cal. Sept. 26, 2013) (partial dismissal); North Valley Mall, LLC v. Longs Drug Stores California LLC, No. c079281 (Cal. App. Sept. 25, 2018).

See generally a 2006 state-by-state survey by Jolisa Dobbs, archived at https://perma.cc/SLW4-TBP6.

#### *22.11.7.3 A change of control is different*

In contrast: In the U.S., a change of control of a licensee corporation, through a transfer of corporate stock, is **not** an "assignment" of the license requiring licensor consent — assuming that the licensee remained a separately functioning corporation.

See VDF Futureceuticals, Inc. v. Stiefel Labs., Inc., 792 F.3d 842, 846 (7th Cir. 2015) (Posner, J.), *quoting* Kenneth Ayotte & Henry Hansmann, Legal Entities as Transferable Bundles of Contracts, 111 Mich. L. Rev. 715, 724 (2013), *and* Elaine D. Ziff, The Effect of Corporate Acquisitions on the Target Company's License Rights, 57 Bus. Lawyer 767, 789 (2002) (paywalled).

(BUT: An assignment-consent provision could specifically provide that a change of control requires consent.)

### 22.11.8 Consent needed for subsequent reassignment

In case of doubt: Assignor's assignees and successors, if any, must obtain Reviewer's consent to an assignment to the same extent as Assignor.

### 22.11.9 If *Reviewer* assigns the Contract

IF: Applicable law would *not* independently require Assignor to obtain Reviewer's consent to assign the Contract;

AND: Reviewer assigns the Contract;

THEN: After Reviewer's assignment, Assignor need not obtain consent to assignment of the Contract from Reviewer (nor from any direct or indirect assignee of Reviewer).

*Commentary*

When Assignor agreed to *contractually* give Reviewer the power to veto assignment of the Contract by Assignor, an implicit part of the underlying bargain was that the veto would be exercised by *Reviewer*, not by some unknown future successor to Reviewer. Accordingly, this section says that if *Reviewer* assigns the Contract, then Reviewer relinquishes its veto over assignments by Assignor.

(See the commentary at Section 22.11.1.2: for discussion of which categories of contract would require consent to assignment as a matter of law even if the contract itself did not require such consent.)

### 22.11.10 Option: Assignment as Material Breach

IF: This Option is unambiguously agreed to in the Contract;

AND: Assignor assigns the Contract without a consent required by the Contract;

THEN: That assignment will constitute a material breach of the Contract.

*Commentary*

If the Contract *doesn't* include a material-breach clause in the assignment-consent provision, then a non-assigning party might not be able to convince a court that the assignment was a *material* breach. As discussed in the commentary to Tango Clause 22.102 - Material & Material Breach Definition, that might mean that the non-assigning party might not have the right to *terminate* the contract because of the assignment — and if the non-assigning party *purported* to do so, such action might result in "own goal" liability for the non-assigning party itself.

Pretty much exactly this — an "own goal" termination for material breach after an alleged un-consented assignment — occurred in a Fourth Circuit case involving Hess Energy, discussed at Section 22.152.1.5: ).

The above considerations could mean that the non-assigning party would be stuck with a new contract partner; the non-assigning party's only remedy against the assigning party for assigning without consent would presumably be money damages — and it might be difficult and expensive to establish, with evidence, the fact and amount of the damages.

### 22.11.11 Option: Reviewer Deems Itself Insecure

a. When unambiguously agreed to in the Contract, this Option applies if Assignor assigns the Contract in a manner that delegates some or all of Assignor's performance under the Contract.

b. The non-assigning party, by giving notice (see the definition in Clause 22.112), may demand commercially reasonable assurance that Assignor's obligations under the Contract will be duly performed.

c. The non-assigning party's right to demand assurance under subdivision b does not affect any other right or remedy that the non-assign-

ing party might have against Assignor and/or the assignee.

d. IF: The non-assigning party does not receive such assurance within a reasonable time (not to exceed 30 days) after the effective date of the non-assigning party's notice demanding assurance;

THEN: Assignor and the assignee will be deemed to have repudiated the Contract.

*Commentary*

This option is modeled on a similar provision in the [U.S.] Uniform Commercial Code, namely UCC § 2-210(5) (which applies by its terms only to sales of goods).

### 22.11.12 Option: Assignment Void Without Consent

IF: This Option is agreed to;

AND: Assignor assigns the Contract without a Reviewer consent required by the Contract;

THEN: The assignment will be void *ab initio* ("from the beginning").

*Commentary*

What if the contract doesn't say that an unconsented assignment is void?

• Absent agreement otherwise, a court applying the so-called "classical approach" might hold that an assignment was void if made without a required consent.

See, e.g., Condo v. Connors, 266 P.3d 1110, 1117-18 (Colo. 2011).

• In contrast, a court applying the so-called "modern approach" (or one of its variants) might hold that an unconsented assignment was a *breach* of the contract — for which damages might be available — but that the assignment per se was not *void* unless the contract said so, perhaps with requisite "magic words."

See id. at 1119; *cf.* David Caron Chrysler Motors, LLC v. Goodhall's, Inc., 43 A.3d 164, 170-72 (Conn. 2012) (reviewing case law from numerous jurisdictions).

## Clause 22.12 Associated Individual Definition

*Associated Individual*, as to an organization, refers to any individual who, at the time in question, falls into one or more of the following categories:

1. an employee of the organization;

2. an officer or director of the organization, if it is a corporation;

3. a holder of a comparable position, if the organization is of another type, such as a limited liability company; and/or

4. any other individuals expressly specified in an agreement, if any.

*Commentary*

This is a convenience definition.

## Clause 22.13 Attorney Fees - ADR Nonparticipation

a. If this Clause is agreed to, it applies if a party:

1. fails to participate in efforts or proceedings required by a dispute-resolution provision of the Contract; and/or

2. unsuccessfully challenges the enforceability of such a dispute resolution provision.

b. The nonparticipating party will not be entitled to recover attorney fees (see the definition in Clause 22.16) or other dispute-related expenses, of any kind, and that party hereby WAIVES (see the definition in Clause 22.162) any such claim; this will be true even if:

1. the nonparticipating party would otherwise have been entitled to such a recovery, whether under the Contract or under applicable law; and/or

2. the nonparticipating party prevails in the dispute in question or in the challenge against the validity or enforceability of the dispute-resolution provision in question.

*Commentary*

Subdivision a is modeled on a *mediation* provision, which has been enforced by courts, in a standard California residential real-estate purchase agreement.

See Cullen v. Corwin, 206 Cal. App. 4th 1074, 142 Cal. Rptr. 3d 419 (2012) (reversing award of attorney fees to prevailing defendant, on grounds that the defendant had refused to participate in mediation as required by contract); Lange v. Schilling, 163 Cal. App. 4th 1412 (2008) (reversing award of attorney fees to prevailing plaintiff). *Cf.* Thompson v. Cloud, 764 F.3d 82 (1st Cir. 2014), where the court denied the winning party's request for attorney fees under an analogous clause, on grounds that the winning party never asked for mediation and thus the losing party didn't refuse to mediate. *See id*. at 92.

Subdivision b is modeled on a provision in a real-estate sale contract, which stated that "if a party does not agree first to go to mediation, then that party will be liable for the other party's legal fees in any subsequent litigation in which the party who refused to go to mediation loses …."

Wuestenberg v. Rancourt, No. 2020 ME 25, slip op. at 10, ¶ 18 (Me. Feb. 25, 2020) (cleaned up).

## Clause 22.14 Attorney Fees - American Rule

When this Clause is agreed to, each party is to bear its own attorney fees in all litigation, arbitrations, or other Agreement-Related Disputes.

*Commentary*

See the introductory commentary to [NONE].

# Clause 22.15 Attorney Fees - Grave Accusations

## 22.15.1 Introduction; applicability

a. When this Clause is agreed to, it applies if the following prerequisites are met:

1. a party (the "*Accuser*") makes a "Grave Accusation" (defined in subdivision b below), against another party; but

2. in the final judgment or arbitration award, as the case may be, from which no further appeal is possible,

the tribunal does not affirmatively find that the accusation was proved by:

(i) the proof required by law, or

(ii) if greater, the proof required by the Contract.

b. The term "*Grave Accusation*" refers to any assertion that one or more other individuals and/or organizations (each, an "*accused*") engaged or is engaged in one or more of:—

1. conduct punishable as a felony under applicable law; and/or

2. fraud.

*Commentary*

### *22.15.1.1 Purpose*

This Clause could be included to discourage litigation counsel from loading up their pleadings with accusations of fraud, gross negligence, bad faith, breach of fiduciary duty, and the like — whether or not such accusations are really warranted by the facts.

> For an example of such accusations, see Falco v. Farmers Ins. Gp., 795 F.3d 864 (8th Cir. 2015), in which the appeals court affirmed summary judgment in favor of defendants, including dismissal of the plaintiff's claim that the defendants had supposedly breached a fiduciary duty.

When counsel do this, the strategic thinking often seems to be something like the following: *What the hell, we might as well go ahead and make these accusations — there's no downside to us for doing so, and the jury might believe us. That will raise the stakes for the other side; this in turn will give us more leverage to force the other side to settle the case on* our *terms.*

#### *22.15.1.2 The harm of unproven Grave Accusations*

Unfortunately, even when Grave Accusations are baseless, they can pose major problems for their targets, because:

- such accusations can unfairly influence jurors;
- in themselves such accusations can damage a defendant's reputation (because third parties can tend to think, *where there's smoke, there's fire*), even if the defendant is ultimately vindicated — and the later vindication seldom receives the same level of publicity as the earlier accusation;
- such accusations are almost always expensive and time-consuming both to prosecute and to defend against, because wide-ranging discovery and expert testimony will usually ensue; and
- such accusations can be tough to get rid of quickly, either on the pleadings or on summary judgment, because judges will often find that a full trial (usually a jury trial in the U.S.) is required to decide the truth of the matter.

### 22.15.2 Expense shifting

When this Clause applies, the Accuser must reimburse the other party for all of the other party's Attorney Fees (see the definition in Clause 22.16) incurred in the entire case, not merely in defending against the unproved Grave Accusation, *unless* the tribunal determines otherwise for good reason.

*Commentary*

The risk of expense-shifting is intended to encourage parties to think long and hard before making a Grave Accusation, by giving them a significant financial downside if they make such an accusation but then fail to prove it.

### 22.15.3 No cost- or expense recovery by Accuser

In addition, when this Clause applies, the Accuser may not recover any of its own Attorney Fees of the litigation or arbitration,

> and the Accuser hereby WAIVES (see the definition in Clause 22.162) any such recovery,
>
> regardless whether the Accuser would have been otherwise entitled to such a recovery under the Contract and/or applicable law.

### 22.15.4 Liquidated damages

When this Clause applies, the Accuser must also pay the other party USD $10,000 as liquidated damages,

> representing the parties' best guess of what the other party would suffer in the way of additional expense, burden, and inconvenience for defending against the unproved Grave Accusation(s) in the case,
>
> *unless* the tribunal determines otherwise for good reason.
>
> (This is over and above the Accuser's Attorney-Fee obligation under [NONE].)

*Commentary*

The good-reason exception is intended to give the tribunal some flexibility in close cases, and also to protect the enforceability of the other sections of this Clause.

### 22.15.5 Severability

a. Except as provided in subdivision b, any and all parts of this section are severable from the Contract if found to be unenforceable for any reason.

b. *Exception:* [NONE], in which the Accuser waives any right to cost- or expense recovery, is not severable.

*Commentary*

The intent here, again, is to give a tribunal some discretion in close cases, while not allowing the Accuser to recover attorney fees if it fails to prove a Grave Accusation.

## Clause 22.16 Attorney Fees - Prevailing Party

### 22.16.1 Definitions: Attorney Fees; Proceeding

a. The term *Attorney Fees* (whether or not capitalized) refers to any and all of the following:

1. reasonable fees billed by attorneys, law clerks, paralegals, and others acting under attorney supervision, and expert witnesses;

2. reasonable expenses incurred by any persons described in subdivision 1 in connection with the Proceeding in question (defined below),

such as, without limitation, printing, photocopying, duplicating, and shipping; and

3. costs of court and/or arbitration, including without limitation arbitration-administration fees and arbitrator fees and expenses.

b. *Definition — "Proceeding":* For purposes of this Clause:

1. The term "*Proceeding*" refers, without limitation, to:

(i) pre-hearing and hearing proceedings, in a court- or contested-administrative action or arbitration;

(ii) an appeal at any level; and/or

(iii) any other contested proceeding in the action or arbitration.

2. The term *Proceeding* includes but is not limited to:

(i) interim proceedings such as motion- and petition practice; and

(ii) appeals from decisions in such interim proceedings (to the extent permitted under applicable law).

*Commentary*

#### *22.16.1.1 Subdivision a: Definition of Attorney Fees*

The definition in this subdivision is informed in part by the attorneys-fees clause in the contract in suit in a Delaware case.

See Seaport Village Ltd. v. Seaport Village Operating Co., No. 8841-VCL (Del. Ch. Sept. 24, 2014) (letter opinion awarding attorney fees).

#### *22.16.1.2 Subdivision b: Definition of Proceeding*

The definition in this subdivision has in mind that pre-hearing motion practice can be a major expense in a lawsuit or arbitration. Allowing a court to award attorney fees

for motion practice and other interim proceedings can help encourage the parties to be reasonable in the positions they take.

#### *22.16.1.3 Background: American Rule vs. Loser-Pays Rule*

Attorney fees are a major expense (perhaps *the* major expense) of contract disputes.

• In U.S. jurisdictions the so-called "American Rule" is that each party must bear its own attorney fees.

> See, e.g., Zurich American Insurance Co. v. Team Tankers A.S., 811 F.3d 584, 590 (2d Cir. 2016) (reversing award of attorney fees and discussing American Rule), *citing* Baker Botts LLP v. ASARCO LLC, 576 U.S. 121, 135 S. Ct. 2158 (2015).

(The American Rule can be explicitly adopted using [NONE].)

• On the other hand, in most non-U.S. jurisdictions, under the so-called prevailing-party rule — sometimes called the "loser pays" rule or the "everywhere but America" rule — a prevailing party is entitled to recover its attorney fees from the losing party. Many contracts adopt the prevailing-party rule using language such as that of this Clause.

#### *22.16.1.4 The "Texas rule": Some contract claimants can recover fees*

If a party negotiating a contract thinks it might be more likely to be the defendant in a dispute than the plaintiff, AND Texas law will apply, then that party it might want to affirmatively include the American Rule option in subdivision g. That's because under Texas law, absent an agreement otherwise, a party is entitled to recover its attorney fees if:

- it successfully enforces a claim
- against *an individual or corporation*
- on an oral or written contract.

> See Tex. Civ. Prac. & Rem. Code § 38.001; see Hoffman v. L&M Arts, No. 3:10-CV-0953-D, slip op. at part III (N.D. Tex. Mar. 6, 2015) (citing cases) (subsequent history omitted).

Importantly: A party that successfully *defends* against an enforcement action is *not* entitled to recover attorney fees under that Texas statute. "Chapter 38 does not provide for recovery of attorneys' fees by defendants who only defend against a plaintiff's contract claim and do not present their own contract claim."

> Polansky v. Berenji, 393 S.W.3d 362, 368 (Tex. App.—Austin 2012) (reversing and rendering award of attorney fees to defendant that prevailed against breach-of-contract claim), *citing, e.g.,* Energen Resources MAQ, Inc. v. Dalbosco, 23 S.W.3d 551, 558 (Tex. App.—Houston [1st Dist.] 2000).

#### *22.16.1.5 Statutes might entitle particular parties to attorney fees*

By statute, legislatures have allowed or even required awards of attorney fees to specified classes of parties. For example:

• U.S. antitrust law requires "a reasonable attorney's fee" to be awarded to "any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws …."

15 U.S.C. § 15(a).

As one example, a federal district court in California awarded more than $40 million in attorney fees to a group of current and former student athletes who sued the NCAA over the college sports rule that prohibited student athletes from being paid for use of their names and likenesses in advertising and video games. See O'Bannon v. NCAA, No. 09-3329 (N.D. Cal. Mar. 31, 2016), *aff'd*, No. 16-15803 (9th Cir. Jun. 29, 2018) (unpublished). The district court had reduced the original fee award of nearly $46 million, granted by a magistrate judge. See 114 F. Supp. 3d 819 (N.D. Cal. 2015) (magistrate judge award).

• Under Cal. Civ. Code § 1021.9: "In any action to recover damages to personal or real property resulting from trespassing on lands either under cultivation or intended or used for the raising of livestock, the prevailing *plaintiff* shall be entitled to reasonable attorney's fees in addition to other costs, and in addition to any liability for damages imposed by law." (Emphasis added.)

As explained by a court: "The statute is intended to ensure that farmers are able to protect their land from trespassers through civil litigation." Kelly v. House, 47 Cal. App.5th 384, 390 (Cal. App. 2020) (reversing denial of statutory attorney fees), *citing* Cal. Civ. Code § 1021.9.

#### *22.16.1.6 The "California rule": It's all "prevailing party"*

California Civil Code § 1717 provides, in essence, that any one-way attorney fees provision (as is sometimes seen in consumer-facing contract forms) is to be treated as a prevailing-party provision, and states that attorney fees under the section cannot be waived.

Likewise in Oregon: Or. Rev. Stat. § 20.096 (2017).

In Florida, Fla. Stat. 57.105(7) has a somewhat-similar provision that allows, but does not require, a court to award prevailing-party attorney fees to either party if a contract contains a one-way attorney fees provision.

See generally Ham v. Portfolio Recovery Associates, LLC, No. SC18-2142 (Fla. Dec. 31, 2020).

#### *22.16.1.7 One-sided attorney-fee clauses might well be enforced*

Some contracts contain unilateral attorneys' fee clauses; for example, a real-estate lease might state that the *landlord* can recover its attorney fees if it has to sue the tenant, while remaining silent as to whether the *tenant* can ever recover its attorney fees. Such unilateral clauses might well be enforceable.

See, e.g., Allied Indus. Scrap, Inc., v. OmniSource Corp., 776 F.3d 452 (6th Cir. 2015) (reversing district court's holding that unilateral fee-shifting provision was unenforceable under Ohio law), *discussing* Wilborn v. Bank One Corp., 906 N.E.2d 396 (Ohio 2009) (affirming dis-

missal of borrowers' lawsuit against lenders claiming that unilateral attorneys' fee clause in residential mortgage loan agreement form was void as contrary to public policy).

(Under the 'American rule,' that would normally mean that the tenant could not recover, even if it were the prevailing party in a suit brought by the landlord — unless a statute provides otherwise, as in the Texas and California examples mentioned above.)

#### *22.16.1.8 Apostrophe, or not?*

The term "attorney fees" is most-often rendered as *attorneys' fees* or *attorney's fees*, following the usage in, e.g., some statutes.

See, e.g., 42 U.S.C. § 1988 (civil rights), which uses "a reasonable attorney's fee"; 28 U.S.C. § 1927, which provides for awards of excess "attorneys' fees" against attorneys who "multiplies the proceedings in any case unreasonably and vexatiously …."

The Tango Terms generally omit the apostrophe, following something of a trend noted by preeminent legal lexicographer Bryan Garner.

See Bryan A. Garner, LawProse Lesson #115: Is it attorney's fees or attorneys' fees? (no year listed; the comments to the post are from 2013).

### 22.16.2 Prevailing-party recovery of Attorney Fees

a. *Entitlement:* In any Proceeding, the prevailing party is entitled to recover its Attorney Fees, in addition to any other interim- and/or final relief to which the prevailing party shows itself to be entitled.

b. *Determination of prevailing party:* In determining which is the "prevailing" party, the tribunal is requested (if a court) or directed (if an arbitral tribunal) to take into account:

a. the claims asserted;

b. the amount(s) of money sought versus the amount(s) awarded; and

c. offsets and counterclaims asserted (successfully or otherwise) by the other party.

*Commentary*

This language is adapted from a slide in a June 2020 CLE Webinar on "Commercial Contract Pitfalls" by Locke Lord attorneys Janet E. Militello and Brandon F. Renken.

Just what constitutes a "prevailing" party can be very fact-specific; some courts have held that, if the putatively winning side did not receive any monetary damages or equitable relief, then it will not be considered the prevailing party for purposes of an attorney fee award.

See, e.g., Intercontinental Group Partnership v. KB Home Lone Star LP, 295 S.W.3d 650 (Tex. 2009), where a 5-4 majority of the state supreme court reversed a $66,000 attorney-fee award to a plaintiff that had received a zero-dollar damages award and no declaratory– or other equitable relief.

### 22.16.3 No appeal or recapture of interim awards

a. *No appeal of interim denials:* To reduce the chance of satellite litigation over Attorney-Fee demands in motion practice and other interim Proceedings, each party WAIVES (see the definition in Clause 22.162) any right to appeal a decision by a tribunal *not* to award some or all requested Attorney Fees for an interim Proceeding.

b. *No recapture of interim awards:* If a party is required to pay or reimburse Attorney Fees for an interim Proceeding, that party WAIVES (see the definition in Clause 22.162) any right it might have to recapture the payment or reimbursement if that party is later awarded damages, or its own Attorney Fees, or any other monetary amount.

## Clause 22.17 Audits

Contents:

### 22.17.1 Introduction; parties

This Clause applies if and when, under the Contract, a specified party (an "*auditing party*") may have audits conducted of specified records kept by another specified party (a "*recordkeeping party*").

*Commentary*

*22.17.1.1 Purpose*

*Trust, but verify.* — Russian proverb, often quoted by the late President Ronald Reagan.

Any time a party will be depending on information reported by another party, the party that will be receiving the reports should consider negotiating to get the right to audit the reporting party's records.

One fraud examiner asserts that "entities often implicitly trust vendors. but just as good fences make good neighbors, vendor audits produce good relationships"; he lists a number of things that fraud examiners watch for, including, for example:

- fictitious "shell entities" that submit faked invoices for payment;

- cheating on shipments of goods, e.g., by short-shipping goods or sending the wrong ones;
- cheating on performance of services, e.g., by performing unnecessary services or by invoicing for services not performed;
- billing at higher-than-agreed prices;
- kickbacks and other forms of corruption;

and others.

See Craig L. Greene, Audit Those Vendors (2003).

#### *22.17.1.2 An audit-provision checklist*

The subheadings of this Clause provide a list of issues that an audit provision could address, such as:

- how often audits may be conducted;
- deadlines for asking for an audit of a particular record;
- how much advance notice of an audit must the auditing party give;
- how big a discrepancy should be required before the recordkeeping party will be required to reimburse the auditing party for its audit expenses;
- whether the recordkeeping party should be entitled to reimbursement for *its* audit expenses.

See also Tango Clause 22.84 - Inspections Protocol

### 22.17.2 Definition: Auditable records

The term "*auditable records*" refers to records sufficient to document each of the following, as applicable under the Contract:

1. labor and/or materials billed to the auditing party;
2. other items billed to the auditing party;
3. compliance with specific requirements; and
4. any other clearly-agreed auditable matters;

unless the Contract clearly provides otherwise.

*Commentary*

For particular contracts, parties might want to add items to the above list, remove items, or go into more detail about certain already-listed items.

### 22.17.3 Form of records to be provided to auditors

The recordkeeping party must make all auditable records available to the auditors in the form in which the records are kept in the ordinary course of business.

*Commentary*

*22.17.3.1 Purpose*

Auditors will usually want to see records in the form in which they're kept in the ordinary course of business. That's because:

- handing auditors a stack of hard-copy printouts of computer records would no doubt significantly increase the cost of the audit; and
- seeing the records in their original forms — possibly including the associated "metadata" — could help auditors detect signs of tampering, which might indicate fraud.

  See generally Ryan C. Hubbs, The Importance of Auditing In An Anti-Fraud World — Designing, Interpreting, And Executing Right to Audit Clauses For Fraud Examiners, at 4 (Assoc. of Certified Fraud Examiners 2012).

*22.17.3.2 Pro tip: Restrict auditors' access?*

A recordkeeping party might want to restrict auditors' access to the party's facilities, computers, etc. For example, in audits of a licensee's usage of software, a possible compromise might be to allow a third-party auditor to have limited access to the licensee's computer systems, etc., under a strict confidentiality agreement.

See Christopher Barnett, Top Three Revisions To Request In Software License Audit Clauses (ScottAndScottLLP.com 2015).

(The recordkeeping party might want to consider including Tango Clause 22.33 - Computer System Access in the Contract.)

### 22.17.4 Maximum allowable frequency of audits

An auditing party may request an audit only up to once per 12-month period and once per period audited, whichever is more restrictive, *unless* good reason exists (see the definition in Clause 22.84.11) for more-frequent audits.

*Commentary*

An audit might well be at least somewhat burdensome and disruptive to the record-keeping party. Some recordkeeping parties might therefore want to negotiate limits stated in this section.

### 22.17.5 Advance notice requirement

An auditing party must give the recordkeeping party at least ten business days' notice (see the definition in Clause 22.112) of any proposed audit, *unless* good reason (see the definition in Clause 22.84.11) clearly exists for an audit on shorter notice.

*Commentary*

Normally both parties will benefit if the recordkeeping party has a reasonable time to collect its records, remedy any deficiencies, etc., before the auditor(s) get there.

On the other hand, a surprise audit might be in order if the auditing party has reasonable grounds to suspect cheating or other malfeasance.

### 22.17.6 Deadline for requesting an audit

An auditing party may request an audit of any particular record only on or before the **later** of the following dates:

1. the end of any legally enforceable record retention period for that record, if any; and

2. the end of three years following the end of the calendar quarter in which the substantive content of the record was most-recently revised.

*Commentary*

A recordkeeping party might want to negotiate a deadline for requesting an audit, after which the records in question become uncontestable absent good reason. That's because:

- at some point, the recordkeeping party might want to be able to get rid of its records;
- the recordkeeping party likely wouldn't want to have to support an audit of (say) 20 years of past records; and
- "sunset" provisions can be a Good Thing generally.

EXAMPLE: In a Hollywood-related case, an audit deadline came into play in a dispute over profits from the TV show *Home Improvement*; the plaintiffs were writers and producers of the

show. See Wind Dancer Production Group v. Walt Disney Pictures, 10 Cal. App. 5th 56, 78-79, 215 Cal. Rptr. 3d 835 (2017).

Absent a deadline for requesting an audit, a creative counsel might try to argue that the counsel's client still had the right to conduct an audit even when, for example, the underlying agreement had expired or been terminated — a labor union tried (unsuccessfully) to make such an argument in a First Circuit case.

See New England Carpenters Central Collection Agency v. Labonte Drywall Co., 795 F.3d 271 (1st Cir. 2015) (affirming judgment).

### 22.17.7 Incontestability of records after audit deadline

After the relevant deadline for requesting an audit has passed (see [NONE]), the particular record in question is to be deemed uncontestable, *unless* the auditing party shows, by clear and convincing evidence (defined in [NONE]) — that good reason (see the definition in Clause 22.84.11) exists for a later audit.

*Commentary*

This section is a corollary to the audit-request deadline in [NONE].

### 22.17.8 Permissible auditors

a. *No contingent-fee auditors:* An audit may not be conducted by any auditor working on a contingent-fee basis, even if that auditor would otherwise be eligible under this section.

b. *Big Four accounting firms:* An auditing party may engage any Big Four accounting firm to conduct an audit under this Clause unless otherwise stated in this section.

c. *Recordkeeping party's own regular auditor(s):* An auditing party may engage any independent accounting firm that regularly audits the recordkeeping party's relevant records; the auditing party WAIVES (see the definition in Clause 22.162) any conflict of interest in that regard.

d. *Consent requirement for other auditors:* Any other auditor(s) must have the recordkeeping party's consent.

1. Such consent is not to be unreasonably withheld.

2. The recordkeeping party is deemed to have consented to a proposed auditor if the recordkeeping party does not give the

auditing party notice (see the definition in Clause 22.112) of its objection within five business days after receiving or refusing the auditing party's written proposal to use that auditor.

*Commentary*

An auditing party might not want to bear the expense of having an outside auditor do the job, and instead might prefer to send in one of its own employees to "look at the books." BUT: A recordkeeping party might not want the auditing party's own personnel crawling around in the recordkeeping party's records, but might be OK with having an outside accountant (or other independent professional) do so.

Subdivision a (no contingent-fee auditors): This is sometimes seen in real-world audit provisions.

Subdivision b (Big Four firms): It's pretty typical for audit clauses to allow Big Four accounting firms to conduct audits.

Subdivision c (recordkeeping party's own auditors): Contracts consultant John Tracy, suggests, in a LinkedIn discussion thread (membership required), that an auditing party should consider engaging the outside CPA firm that regularly audits the recordkeeping party's books. He says that this should reduce the cost of the audit and assuage the recordkeeping party's concerns about audit confidentiality; he also says that "the independent CPA will act independently rather than risk the loss of their *[sic]* license and accreditation and get sued for malpractice."

Subdivision d (reasonable consent requirement for other auditors): A recordkeeping party might want the absolute right to veto the auditing party's choice of auditors, instead of having the right to give reasonable consent. On the other hand, the auditing party might not trust the recordkeeping party to be reasonable in exercising that veto, and could be concerned that a dispute over that issue would be time-consuming and expensive. This provision represents a compromise.

(The specific time limit for objection by the recordkeeping party might be something to be negotiated.)

### 22.17.9 Location and working hours for audits

Unless otherwise agreed, the recordkeeping party must allow each audit to be conducted:

1. at the location or locations where the auditable records are kept in the ordinary course of business;

2. during the regular working hours, at that location, of the party having custody of the records; and/or

3. at one or more other reasonable times and places, designated in advance by the recordkeeping party in consultation with the auditing party.

*Commentary*

For any given audit, the parties might want to agree — in writing, of course, albeit informally, e.g., by email — to different working hours and/or location for the audit.

### 22.17.10 Auditor workspace

IF: An audit is to be conducted at one or more sites controlled by the recordkeeping party;

THEN: The recordkeeping party, at its own expense, is to cause the audit site(s) to be furnished with appropriate facilities, of the type customarily used by knowledge-based professionals.

*Commentary*

In an unfriendly audit, an uncooperative recordkeeping party might try to make the auditors work in a closet, a warehouse, or worse.

### 22.17.11 Cooperation with auditors

Except as otherwise provided in this Clause, the recordkeeping party must:

1. make its relevant personnel reasonably available to the auditors, and

2. direct those personnel to answer reasonable questions from the auditors.

*Commentary*

This section anticipates the possibility of "unfriendly" audits.

### 22.17.12 Off-limits information

The recordkeeping party need not allow the auditor(s) to have access to any of the following:

1. information that, under applicable law, would be immune from discovery in litigation, including without limitation on grounds of attorney-client privilege, work-product immunity, or any other privilege;

2. trade secrets and other confidential information relating to formulae and/or processes; and

3. clearly-unrelated or -irrelevant information.

*Commentary*

In the case of the attorney-client privilege, disclosure of privileged information to outsiders likely would waive the privilege in many jurisdictions and thus make the privileged information available for discovery by others, including third parties.

A recordkeeping party might also want to specify other particular audit exclusions.

Subdivision 3's exclusion might be open to dispute, but at least it gives the recordkeeping party ammunition with which to oppose an unreasonable "fishing expedition" by the auditing party.

### 22.17.13 Auditors' confidentiality obligations

Auditors must agree in writing to comply with the same confidentiality obligations that apply to the auditing party.

*Commentary*

Outside auditors might not want to take the time (and expense) of reviewing, negotiating, and signing a confidentiality agreement. An advantage of using independent accounting firms is that (in most jurisdictions) they will have at least some *ethical* obligations to maintain the confidentiality of the records they audit, regardless whether a written confidentiality agreement is in effect.

### 22.17.14 Auditor retention of copies

a. *Retention:* The auditors may make and keep copies of auditable records, in accordance with professional practice standards,

subject to the confidentiality- and return-or-destruction provisions of this Clause.

b. *Destruction in due course:* In due course, the auditors must destroy or return any copies that they retain under this section,

in accordance with the auditors' regular, commercially-reasonable policies and processes.

*Commentary*

An auditing party's auditors might well find it burdensome (and therefore more expensive for the auditing party) to be precluded from making copies of the record-keeping party's records. Moreover, outside auditors might insist on being able to take copies with them to file as part of their work papers.

However, in some circumstances, the recordkeeping party might want to negotiate for limits on the types of records that the auditor(s) are allowed to copy and take away.

Of historical interest: The Big-Five accounting firm Arthur Andersen was destroyed because it belatedly shredded its files concerning its audits of Enron, which led to the firm's conviction for obstruction of justice — the U.S. Supreme Court unanimously reversed the conviction, but by then it was too late to save the firm. See Arthur Andersen (Wikipedia.org)

Also of interest to lawyers: Andersen's belated shredding of documents was prompted by a "reminder" email from an Andersen in-house lawyer, who was never criminally charged but became practically unemployable as a result of the fallout:

> "It might be useful to consider reminding the [Enron] engagement team of our documentation and retention policy," [the in-house lawyer] wrote in an e-mail to an Andersen partner before Enron filed for bankruptcy. "It will be helpful to make sure that we have complied with the policy." * * *
>
> In 2002, [the lawyer's] options were limited. *She couldn't return to BigLaw, including Sidley Austin where she had once worked. No public company would be willing to hire her*. So she became a solo, taking a route "far from the white-shoe legal world she had known, through criminal law, risky contingent-fee cases and small-fry clients," Crain's says.

Debra Cassens Weiss, How an Arthur Andersen Lawyer Rebuilt Her Career (ABAJournal.com 2010) (emphasis added); see also Nancy Temple (Wikipedia.org) for a more-detailed account of the lawyer's advice email.

During President Donald Trump's efforts to overturn the results of the 2020 presidential election that turned him out of office, Ms. Temple appeared as counsel on an amicus brief for 17 individuals who opposed the Texas attorney general's attempt to file an original-jurisdiction lawsuit in the Supreme Court against six swing states that had voted for President-elect Joseph Biden.

### 22.17.15 Copy of audit report to recordkeeping party

IF: the recordkeeping party so requests in writing to the auditors,

with a copy of the request to the auditing party;

THEN: The auditors must promptly furnish the recordkeeping party with a complete and accurate copy of the audit report, at no charge.

*Commentary*

A recordkeeping party might not care about getting a copy of the audit report if all the report says is, basically, *everything's cool here*.

But if the recordkeeping party will have to come up with extra money — or if the audit report says that the auditing party has materially breached the Contract — then the recordkeeping party likely will indeed want a copy of the audit report.

An auditing party might not want to provide a copy of the audit report to the recordkeeping party. But let's face it:

- If the dispute goes to litigation or even arbitration, the odds are high that the recordkeeping party's lawyers will be able to get a copy of the audit report as part of the discovery process (for example, by issuing a subpoena to the auditors).
- And any confidential information in the audit report is presumably the recordkeeping party's confidential information.

So it's hard to think of a good reason for the recordkeeping party *not* to get a copy of the audit report.

### 22.17.16 Corrective action after an audit

a. Each party must promptly correct any discrepancy revealed in an audit,

where that party was responsible for the discrepancy,

for example, an overbilling or an underpayment.

b. In case of doubt: No invoice need be sent for a payment required under this section; a complete and accurate copy of the audit report (if not already provided) and a written request for payment will suffice.

*Commentary*

Subdivision b's "no invoice" provision is for clarity.

### 22.17.17 Interest rate for past-due amounts

a.

A party that is found by an audit to owe money due to that party's error (or other fault) must pay simple interest to the other party on the

unpaid balance of the amount(s) owed,

at the rate of 1.5% per month, or if less, the maximum rate permitted by law,

beginning on the date the money was originally due, or if later, the earliest start date permitted by law,

and continuing until paid in full.

b. Tango Clause 22.160 - Usury Savings will apply.

*Commentary*

The interest rate might be negotiated, but too-low a rate would give a party an incentive (possibly a small one) to cheat.

### 22.17.18 Audit expense shifting

a. *Triggers for expense-shifting:* This section applies if the audit was occasioned by, or revealed or confirmed, one or more of the following, (i) on the part of the recordkeeping party, or (ii) for which the recordkeeping party is responsible either by law or as stated in the Contract:

1. overbilling or underpayment (as applicable) by more than 5% for the period being examined;

2. fraud; and/or

3. material breach (see the definition in Clause 22.102.2).

b. *Expense-reimbursement requirement:* When this section applies (see subdivision a), the recordkeeping party must reimburse the auditing party for its reasonable out-of-pocket expenses actually incurred, including without limitation reasonable fees and expenses charged by the auditor(s).

c. *No expense shifting otherwise:* As between the recordkeeping party and the auditing party, each party is responsible for all of its audit-related expenses unless the Contract clearly says otherwise.

*Commentary*

Subdivision a.1: The threshold for shifting audit expenses to the recordkeeping party might well be negotiable. It often will fall in the range between 3% and 7% for royalty-payment discrepancies and perhaps 0.5% for billing discrepancies in services.

This section calls for expense-shifting if a discrepancy of a stated percentage is revealed "for the period being examined." Why? Suppose that in an audit of five years'

worth of records, the auditors discover a 5% discrepancy in the records for a single month. In that situation, the recordkeeping party shouldn't have to foot the bill for the expense of the entire five-year audit.

Subdivision c: Reimbursement of *the recordkeeping party's* expenses can be addressed with [NONE]. A recordkeeping party might want that, because its own audit expenses might not be trivial: An article notes that "audit provisions rarely address the apportionment of the costs incurred by the contractor or its subcontractors in facilitating the audit, managing the audit, reviewing and responding to the audit results, and other related activities if the audit fails to demonstrate significant overbilling by the contractor."

Albert Bates, Jr. and Amy Joseph Coles, Audit Provisions in Private Construction Contracts …, 6 J. Am. Coll. Constr. Lawyers 111, 132 (2012).

### 22.17.19 Option: Recordkeeping Party Expense Reimbursement

a. This Option applies only if the Contract unambiguously says so.

b. IF: For a particular audit, the *recordkeeping* party is not required to reimburse the auditing party's expenses of the audit;

> THEN: The *auditing* party must reimburse the recordkeeping party,
>
> > and the recordkeeping party's subcontractors, if applicable,
>
> for reasonable expenses that the recordkeeping party (and/or its subcontractors) actually incurred in connection with the audit.

c. Such expenses would include, without limitation, reasonable fees and expenses for an auditor engaged by the recordkeeping party (if any) to monitor the audit.

*Commentary*

Audits aren't cost-free for the *recordkeeping* party, so such a party might ask to be reimbursed for its audit expenses if the audit doesn't reveal significant problems.

See also the commentary to [NONE] (audit expenses).

### 22.17.20 Option: True-Up as Exclusive Audit Remedy

a. This Option applies only if the Contract unambiguously says so *and* both of the following are true:

1. The auditor's report provides clear support for the existence of a discrepancy for which the recordkeeping party is responsible; and

2. The recordkeeping party complies with the discrepancy-related requirements of this Option within ten business days after the recordkeeping party receives a copy of the auditor's report.

b. Except as provided in subdivision c, the recordkeeping party's compliance with those discrepancy-related requirements will be the recordkeeping party's only liability, and THE AUDITING PARTY'S EXCLUSIVE REMEDY, for the discrepancy.

c. The exclusive-remedy limitation of subdivision b will not apply, however, if the audit revealed or confirmed—

1. fraud (see § 22.65); or

2. a material breach (see § 22.102.2) of the Contract,

in either case for which the recordkeeping party was responsible by law and/or under the Contract.

*Commentary*

A software customer might want to include this Option in the Contract as a shield against a forceful software licensor (cough, Oracle), if an audit by the licensor revealed that the customer was making more use of the software than it had paid for.

See, e.g., Christopher Barnett, Top Three Revisions To Request In Software License Audit Clauses (ScottAndScottLLP.com 2015), archived at https://perma.cc/Y9U5-LKXE.

Software licensors might well be willing to go along with such a limitation of liability — but possibly with the proviso that any catch-up license purchases would be at full retail price, regardless of any negotiated discount; otherwise the customer would have an incentive to roll the dice and cheat on obtaining licenses.

On the other hand, an auditing party might object to this provision if it wanted to be free also to demand a greater measure of damages for the discrepancy revealed by the auditor's report if that were available by law — such as indirect damages resulting from copyright infringement if the audit showed that the recordkeeping party had used licensed software for more than the recordkeeping party had paid for.

Something like this came to pass in a case where a jury awarded $5 million, or 2.2% *of defendant's total profits* for the period in question, as "disgorgement" copyright damages for the defendant's infringement of the plaintiff's computer software.

See ECIMOS, LLC v. Carrier Corp., 971 F.3d 616 (6th Cir. 2020) (affirming judgment on jury verdict); see also the commentary to [NONE].

### 22.17.21 Option: Audit Requirement Flowdown

a. This Option applies only if the Contract unambiguously says so.

b. The recordkeeping party must cause each of its subcontracts under the Contract, if any, to include "flowdown" provisions as follows:

1. a requirement that the subcontractor permit audits by the auditing party in accordance with the Contract's audit provisions; and

2. an authorization for the subcontractor to deal directly with the auditing party and its auditors in connection with any such audit.

*Commentary*

Contracts that are expected to involve subcontracts will often contain flowdown requirements, as discussed at [NONE].

### 22.17.22 Reading review: Recordkeeping and audits

FACTS: MathWhiz and Gigunda are agreeing to a variation of their basic data-analysis deal: Instead of a flat *monthly* rate, MathWhiz will charge Gigunda *hourly* rates plus out-of-pocket expenses.

Working together in your breakout rooms:

1. List *one* point from this reading that you're glad you knew *before* doing the reading — or that you're glad you learned *from* doing it.

2. List *three* points in this reading that you would want *MathWhiz* to be sure to know if you were representing that company.

3. Same as #2, but this time as if you were representing *Gigunda*.

## Clause 22.18 Background Checks

### 22.18.1 Introduction; parties

This Clause applies if and when, under the Contract:

a specified party (a "*checking party*") has background checks performed on one or more individuals (each, a "*checked individual*"),

in connection with the performance of services or other obligations for another party (a "*requesting party*").

*Commentary*

*22.18.1.1 Business context*

It's not uncommon for customers to want service providers to have background checks done on the providers' key personnel. The goal is normally to identify people with criminal records, drug problems, or other indicia of potential trouble. This can be a sensitive topic, possibly with legal complications.

A customer might especially want (or need) for a supplier to have background checks run on the supplier's personnel, for example:

- if the customer is a government contractor;
- if the supplier will have access to the customer's confidential- or sensitive information; or
- if the supplier's personnel will "face" the customer's own customers or clients, that is, be seen or heard by them.

Contract drafters can use the defined terms in [NONE] to specify particular background checks to be performed.

*22.18.1.2 Caution: Hazards of background checks*

Background checks can pose dangers for parties requiring them:

- Suppose that a customer requires a provider to have background checks done on all provider personnel who will be accessing the customer's premises.
- Then suppose that an employee of the provider complains that the background check violated his rights under applicable law.

The provider's employee might be tempted to sue the *customer*, not just the provider.

(In that situation, [NONE] would require the provider to protect the customer from the cost of defending and/or paying damages for such claims.)

*22.18.1.3 Caution: Consent requirements*

Parties conducting (or commissioning) background checks should be sure to check applicable law to see if any particular form of consent is required; see, for example, the discussion of consent requirements in Section 22.18.1.4: .

It might be prudent to obtain consent to a background check even if the law *doesn't* require consent: If the individual were to learn of an unconsented background check, his displeasure might go viral on social media, especially given today's heightened sensitivity to privacy concerns.

#### *22.18.1.4 Credit checks: Special federal consent requirements*

Credit checks, if not done correctly, can get a checking party in trouble under the [U.S.] Fair Credit Reporting Act ("FCRA"). One particular *procedural* requirement comes up in class-action lawsuits: Section 1681b(b)(2)(A) of the FCRA, which states that, with certain very-limited exceptions:

> … a person may not procure a consumer report, *or cause a consumer report to be procured*, *for employment purposes* with respect to any consumer, unless—
>
> (i) a clear and conspicuous disclosure has been made in writing to the consumer at any time before the report is procured or caused to be procured, *in a document that consists solely of the disclosure*, that a consumer report may be obtained for employment purposes; and
>
> (ii) the consumer has authorized in writing … the procurement of the report by that person.

(Emphasis added.)

Hat tip: Ken Remson, Employers Hit With Background Check Lawsuits, May 20, 2014.

Noncompliance with background-check consent requirements has hit some well-known companies with sizable settlement costs.

See, e.g., Todd Lebowitz, Publix to Pay $6.8 Million Settlement over Noncompliant Background Check Forms (EmploymentClassActionReport.com Nov. 3, 2014); David M. Gettings, Timothy St. George and David N. Anthony, Chuck E. Cheese Settles Background Check Lawsuit For $1.75 Million (Mondaq.com 2015).

### 22.18.2 Required types of background check

Criminal History Checks (defined in [NONE]) are required if not otherwise specified in the Contract.

*Commentary*

See generally the definitions in [NONE] (and consider other possible background checks).

Liens and bankruptcy: As an adjunct to a credit check, a party might want to know about an individual's past financial difficulties.

Criminal background checks: See the commentary at [NONE].

Drug testing: See the commentary at [NONE].

Education checks are sometimes used because résumé padding is not an uncommon occurrence.

Examples: • The chief spokesman of Walmart resigned after the retail giant learned that he had falsely claimed to have graduated from college, when in fact he had not finished his course work (DailyMail.com 2014). • Ditto the former dean of admissions at MIT (NPR.org 2015).

Employment checks: Verification of employment *dates*, in particular, can help expose undisclosed résumé gaps — or "fudging" of employment dates as listed on the résumé to shorten or eliminate gaps.

It's thought by some that a good practice is not to rely on employer contact information provided by the (former) employee, but instead to find the contact information independently. Otherwise, it's possible that the "employer" is actually someone colluding with the former employee to provide false information.

Some parties might want to obtain more than just the listed information, adding (for example) job duties, salary history, reason for leaving, and/or eligibility for rehire.

Some parties want employment history for the past five to ten years, or for the past two to five employers.

Residence address checks have in mind that an individual might omit one or more previous addresses in the hope of evading a criminal-records check.

### 22.18.3 Whose backgrounds must be checked

The backgrounds of anyone engaged in Restricted Activities (defined in [NONE]) must be checked.

*Commentary*

The definition of *Restricted Activities* in [NONE] is set up with a view to safety of person and property.

### 22.18.4 Independent sources of contact information

As a safeguard against falsified references, all reference checks, if any,

> other than personal character references,
>
> are to be completed using contact information obtained from a source other than from the checked individual him- or herself.

*Commentary*

By requiring independently-obtained contact information, [NONE] helps to guard against the possibility that an applicant might provide a checking party with fake

contact information for such references — so that when the checking party contacts the "references," the checking party ends up talking to one of the applicant's friends who is in on the scam.

### 22.18.5 Costs of background checks

The checking party must bear all costs of background checks unless the Contract specifies otherwise.

*Commentary*

Service providers often take the view that any customer that wants background checks to be conducted on the provider's personnel should pony up for that cost.

On the other hand, a customer might take the position that background checks should be an overhead expense that the provider must bear.

This section comes down on the side of the customer as a "default" provision, but of course the parties are free to agree otherwise.

### 22.18.6 Standards for self-performed background checks

If a checking party itself performs a background check, it must do so:

a. in a commercially-reasonable manner; and

b. in compliance with law, including without limitation:

any applicable privacy laws, including for example any requirement to obtain the consent of the checked individual; and

any applicable notification requirement, for example, in credit-reporting laws, that the checked individual must be notified before or after a decision is made using information learned in the background check.

*Commentary*

This section sets out a semi-strict standard for a checking party that does background checks itself, as opposed to hiring out the job to a reputable service provider as provided in [NONE].

### 22.18.7 Standards for outsourced background checks

If the checking party does not perform the background check itself, it must:

1. engage a reputable service provider to do so; and

2. contractually obligate the service provider to comply with the requirements of subdivision 1.

*Commentary*

This section establishes a safe harbor if the checking party hires a reputable service provider, instead of DIY (for that alternative, [NONE]).

Even if contracting parties are capable of conducting their own background checks, they're likely to want to outsource the job and offload the responsibility by engaging a reputable outside service, because professionals in that field —

- can use economies of scale to do the work more cost-effectively;
- can be thrown under the bus if something goes wrong; and
- can provide a layer of liability protection against claims by people who had their backgrounds checked (but claims of negligent hiring against the engaging party could still be viable).

### 22.18.8 Procedure if criminal history revealed

IF: A checked individual's background check reveals any Criminal History (see the definition in Clause 22.18.11);

THEN: The checking party must not assign, nor permit, that individual to engage in any Restricted Activity (see the definition in Clause 22.18.11) for the benefit of the requesting party

without first consulting with the requesting party.

*Commentary*

#### *22.18.8.1 Where to get criminal-records checks*

Criminal records checks in basic form seem to be available from any number of Web sites at low cost, including from government agencies.

Examples: • FBI: https://www.edo.cjis.gov. • Texas Department of Public Safety: https://records.txdps.state.tx.us/DpsWebsite/CriminalHistory/.

#### *22.18.8.2 Caution: Unlawful-discrimination charges could ensue*

Using criminal-records checks to deny employment might lead to trouble with government agencies or with the persons checked if the denials have the effect of unlawful discrimination against minorities or other protected classes. A blanket prohibition against using personnel with criminal records could be problematic: It might be alleged to have a disproportionate impact on racial- or ethnic minorities and thus to be illegal in the U.S.

The U.S. Equal Employment Opportunity Commission (EEOC) has filed lawsuits against employers who allegedly "violated Title VII of the Civil Rights Act by implementing and utilizing a criminal background policy that resulted in employees being fired and others being screened out for employment …."

EEOC press release, June 11, 2013; see generally the EEOC general counsel's enforcement guidance published in April 2012.

For example, a blanket prohibition against using personnel with criminal records could be alleged to have a disproportionate impact on racial- or ethnic minorities and thus to be illegal in the United States.

See generally the EEOC general counsel's enforcement guidance published in April 2012.

#### *22.18.8.3 Caution: "Ban the box" statutes can trip up employers*

In addition, some states might likewise restrict an employer's ability to rely on criminal background information in making employment-related decisions. Drafters should pay particular attention to the law in California, New York, Massachusetts, Illinois, and Pennsylvania (not necessarily an exhaustive list). This is because in recent years the practice of *automatically* disqualifying people with criminal convictions has come under fire from government regulators and the plaintiff's bar as being potentially discriminatory (the so-called "ban the box" movement).

For a list of states and cities with ban-the-box laws, see Beth Avery, Ban the Box: U.S. cities, counties, and states adopt fair hiring policies (NELP.com 2019).

### 22.18.9 Procedure if drug use revealed

IF: A checked individual's background check indicates use, by that individual, of one or more of the following: (i) illegal drugs; and/or (ii) prescription drugs other than in accordance with a lawfully-issued prescription;

THEN: The checking party must not assign, nor permit, that individual to engage in —

1. any Critical Activity (see the definition in Clause 22.18.11) for the requesting party without the express prior written *consent* of the requesting party; nor

2. any other Restricted Activity (see the definition in Clause 22.18.11) for the requesting party without first *consulting* with the requesting party.

*Commentary*

*22.18.9.1 Reasons for drug testing*

Customers with safety concerns might want its contractors' employees to be drug-tested. Depending on the duties to be assigned, even the use of legal drugs might disqualify an individual — for example, an individual taking certain prescription medications might be disqualified from (say) driving a bus or other commercial vehicle.

For obvious reasons, if a background check indicates that a person might have a drug-misuse problem, then tighter restrictions are imposed on using the person for Critical Activities than for other Restricted Activities.

*22.18.9.2 Caution: Running afoul of disability laws*

Companies should be cognizant of disability laws such as the Americans with Disabilities Act, which might affect a company's ability to deny employment because of prescribed drug use.

Companies might also consider the possible effect on employee morale of asking them to take a drug test – and about what they might have to do if a valued employee were to bust the test. As the saying goes, be careful about asking a question if you're not prepared to deal with the answer.

### 22.18.10 Responsibility for third-party claims

a. This section applies if a third party (see subdivision c) makes any kind of claim against the requesting party, and/or any other member of the requesting party's Protected Group (see the definition in Clause 22.126), where:

1. the claim arises out of the conduct of a background check under the Contract; and

2. the background check is done (i) by the checking party and/or (ii) at the checking party's request or direction.

b. In such an event, the checking party must defend (as defined in Clause 22.46) the requesting party's Protected Group (as defined in Clause 22.126) against the claim.

c. In case of doubt: The checking party's obligation under this section applies, without limitation, to any claim:

1. by a Checked Individual, and/or
2. by a government authority.

*Commentary*

**Caution:** As with any indemnity obligation, a party expecting to be indemnified should consider pairing the indemnity- and defense obligation with an obligation for the indemnifying party to maintain insurance or other backup financing source, in case the indemnifying party doesn't have the money to comply when the time comes.

### 22.18.11 Definitions for Background Checks

*Credit Check* refers to standard credit reporting from all major credit bureaus serving the jurisdiction in question. See the commentary at [NONE].

*Criminal History*, as to a checked individual, refers to the checked individual's having been convicted of, or having pled guilty or no contest to, one or more of: (1) a felony; and/or (2) a misdemeanor involving fraud or moral turpitude.

*Criminal-History Check* refers to a nationwide check of records of arrests, convictions, incarcerations, and sex-offender status. A Criminal-History Check need not include fingerprint submission to confirm identity. See [NONE] and its commentary.

*Critical Activity* refers to any activity involving a substantial possibility of:

1. bodily injury to or death of one or more individuals, including but not limited to a checked individual; and/or
2. loss of, or damage to, tangible or intangible property, of any kind, of any party other than the checking party; such loss or damage might be physical and/or economic.

*Driving-Record Check* refers to a check of records of accidents; driver's-license status; driver's-license suspensions or revocations; traffic violations; and driving-related criminal charges (e.g., DUI).

*Drug Testing* refers to testing for illegal drugs and controlled pharmaceuticals. See [NONE] and its commentary.

*Education Verification* refers to confirmation of dates of attendance, fields of study, and degrees earned.

*Employment Verification* refers to confirmation of start- and stop dates and titles of employment for the past seven years. See the commentary at [NONE].

*Lien, Civil-Judgment, and Bankruptcy Check* refers to a check of records of tax- and other liens; civil judgments; and bankruptcy filings. See the commentary at [NONE].

*Personal Reference Check* refers to telephone- or in-person interviews with at least three personal references, seeking information about the individual's ethics; work ethic; reliability; ability to work with others (including, for example and where relevant, peers, subordinates, superiors, customers, and suppliers); strengths; areas with room for improvement; personality.

*Residence Address Verification* refers to confirmation of dates of residence addresses for the past seven years. See the commentary at [NONE].

*Restricted Activity* refers to any one or more of the following, when engaged in, in connection with the Contract, by an employee of, or other individual under the control of, a checking party:

1. any Critical Activity (defined above in this section);

2. working on-site at any premises of a requesting party;

3. having access (including without limitation remote access) to the requesting party's equipment or computer network;

4. having access to the requesting party's confidential information; and

5. interacting with the requesting party's employees, suppliers, or customers.

## Clause 22.19 Baseball Arbitration

### 22.19.1 Introduction; covered disputes

This Clause is to be followed in any dispute between the parties — before a court or any other tribunal — where the dispute is about one or more of the following:

1. which is the correct number, e.g., an amount owed; and/or

2. what action is required to comply with an agreed standard or requirement — for example, what would constitute "commercially-reasonable efforts" if the Contract required a party to make such efforts.

*Commentary*

#### *22.19.1.1 Promoting settlement through "baseball" arbitration*

Final-offer or last-offer arbitration, a.k.a. "baseball arbitration" or "pendulum arbitration," promotes settlement because *the decision maker will choose between the parties' competing final proposals*; that gives each party an incentive not to be unreasonable in its proposal.

As one commentator put it, baseball arbitration is "designed to produce a settlement, not a verdict."

> Thomas Gorman, *The Arbitration Process – the Basics*, in Baseball Prospectus (2005) (http://perma.cc/CZR4-9XC7).

Baseball arbitration seems to work quite well in Major League Baseball as a settlement incentive: in 2018, fully 179 out of 201 arbitration-eligible players, or 89%, reached a settlement with their teams without having to go to hearing; in 2019, it was 12 settlements out of 14 arbitration-eligible players, or 86%; and in the coronavirus-pandemic year of 2020, it was 11 settlements out of 14 players, or 78%.

> See Arbitration Tracker 2018, 2019, and 2020.

#### *22.19.1.2 Advantage: Fencing in the arbitrator*

Another perceived advantage of baseball-style decision-making is that, because the tribunal *must* choose between the parties' last offers, the tribunal is not allowed to "go rogue," a possibility that worries some parties (see Section 22.7.17: ), nor is the tribunal allowed to "split the baby," as some are concerned that arbitrators are prone to do (the present author, who sometimes serves as an arbitrator, does not share this concern).

The two categories of dispute listed in this section are especially amenable to promoting settlement by incentivizing the parties to be reasonable.

### 22.19.2 Exchange of settlement proposals

a. *Number of proposals:* The parties are to exchange, in succession, two written proposals to resolve the dispute.

b. *Copies to tribunal:* Each party is to provide the tribunal with a copy of each of that party's settlement proposals.

c. *Explanations:* Each party may include, in any proposal, a brief explanation why it believes the tribunal should select that proposal.

*Commentary*

#### *22.19.2.1 Language origins*

This section borrows from a set of final-offer arbitration rules published by the International Centre for Dispute Resolution (the international division of the American Arbitration Association).

See ICDR Rule 2, Final Offer Arbitration Supplementary Rules (adr.org), archived at https://perma.cc/5TJ6-UKHH (perma.cc).

#### *22.19.2.2 Subdivision a — two rounds of settlement proposals:*

Doing two successive rounds of settlement proposals should help nudge each party into assessing whether *the other party's* proposal might look better *to the tribunal*, which can promote reasonable positions and thus improve the odds of settlement.

See Edna Sussman and Erin Gleason, Everyone Can Be a Winner in Baseball Arbitration: History and Practical Guidance (sussmanadr.com), in N.Y. State Bar Association, *New York Dispute Resolution Lawyer*, Spring 2019, at 30, archived at https://perma.cc/QW76-C7BB.

#### *22.19.2.3 Subdivision b: Telling the tribunal about the proposals*

This subdivision will help the tribunal to size up which party proposal is "closest to the pin" of what the tribunal would award if free to do so.

A variation on this approach is "night baseball," in which the tribunal is *not* given copies of the parties' respective proposals; instead, after the hearing or trial, the tribunal indicates which party wins, and that party's settlement proposal then goes into effect. (That variation, however, seems far less likely to have the settlement-promoting effect of "regular" baseball.)

See CPR, Final Offer or Baseball Arbitration (cpradr.org).

#### *22.19.2.4 Subdivision c: Explanations of proposals*

This subdivision will give the parties' counsel an opportunity to write (what amount to) "post-trial briefs."

### 22.19.3 Tribunal's preliminary expression of views

a. *Advice to parties:* The tribunal, in its sole discretion, may advise the parties of the tribunal's views about the matter in dispute.

b. *Resubmission opportunity:* If the tribunal does advise the parties of its views, it should allow a reasonable time for the parties to submit, and confer about, revised proposals if they so choose.

*Commentary*

It can be helpful if the member(s) of the tribunal disclose their preliminary, provisional impressions of the merits *before* the parties submit their final proposals. Such a disclosure by the tribunal can likely help the parties reassess their settlement positions and thus formulate their next proposals for resolution of the dispute.

Some might be concerned that an arbitrator's preliminary comments could create an impression of arbitrator bias. And a party perceiving that it was going to lose the case could run to court to try to stop the arbitration (this sort of thing has actually happened).

But the ABA/AAA code of ethics for arbitration expressly contemplates that arbitrators will "comment on the law or evidence …. These activities are integral parts of an arbitration."

> Commentary, Canon I of the ABA/AAA Code of Ethics for Arbitrators in Commercial Disputes (https://perma.cc/Y6TX-M97V).

Certainly arbitrators must be vigilant against creating an appearance of bias. But neither should arbitrators be overly fearful of being attacked for bias, because:

- Arbitrators and judges and jurors routinely *and unavoidably* form one or more initial impressions of the merits after the parties' opening statements. What is expected of them (nay, demanded) is that they they *withhold judgment* until all the evidence is in.
- An arbitrator's disclosure of her initial impressions will help to increase the overall transparency of the arbitration proceeding, in the same vein as her disclosure of any past- or present relationships with the parties, counsel, witnesses, etc. If the arbitrator really does have a genuine bias, her disclosure of her impressions might help counsel to identify that bias.

### 22.19.4 Tribunal selection of one proposal

a. IF: The parties' exchange of proposed resolutions does not lead to settlement;

> THEN: The tribunal is respectfully *requested* to select (if a court),

or is *directed* to select (if an arbitral tribunal),

as the resolution of the dispute — without modification —

the one, party-proposed resolution that the tribunal regards as most-closely matching the resolution that the tribunal would award on its own.

b. The tribunal's selection of a party proposal will be binding as an arbitration award.

c. In case of doubt: If the tribunal is an arbitral tribunal, this Clause does not grant the tribunal any other power to decide the parties' dispute.

*Commentary*

The no-other-power language in subdivision c has in mind the case in which the arbitral tribunal does something other than choose between the two alternatives; in such a case, subdivision c should trigger one of the (very few) grounds under which a U.S. court will ordinarily set aside an arbitration award under the Federal Arbitration Act, namely that the arbitrators "exceeded their powers …."

9 U.S.C. § 10(a)(4).

(Of course, *a court* likely would not be bound by the no-other-power language.)

## Clause 22.20 Best Efforts Definition

a. *Best efforts* refers to the diligent making of reasonable efforts to achieve an objective.

b. *Actions not required:* In case of doubt, a party obligated to use best efforts:

1. need not take any unreasonable action;

2. need not take every conceivable reasonable action to achieve the stated objective; and

3. need not materially harm its own lawful interests.

Commentary

### 22.20.1 Cross-references

This definition should be read in conjunction with the definitions of *commercially reasonable efforts* ([NONE]) and *reasonable efforts* ([NONE]). See also the commentary to [NONE] for additional reading about best efforts.

### 22.20.2 Subdivision a: Diligence in making reasonable efforts

This approach comes from Restatement (Second) of Agency, which states: "Best efforts is a standard that has diligence at its essence."

> Restatement (Second) of Agency § 13, comment a (1957), *quoted in* T.S.I. Holdings v. Jenkins, 924 P.2d 1239, 1250, 260 Kan. 703, 720 (1996), *quoted in* Corporate Lodging Consultants, Inc. v. Bombardier Aerospace Corp., No. 6:03-cv-01467-WEB, slip op. at 9 (D. Kan. May 11, 2005) (finding that CLC had not failed to use its best efforts to obtain lowest and most-competitive hotel rates for Bombardier).

### 22.20.3 Subdivision b.1: No *unreasonable* actions required

In its *Hospital Products* opinion (1984), Australia's highest court held that "an obligation to use 'best endeavours' does not require the person who undertakes the obligation to go beyond the bounds of reason; he is required to do all he reasonably can in the circumstances to achieve the contractual object, but no more … [A] person who had given such an undertaking … in effect promised to do all he reasonably could …."

> Hospital Prods. Ltd v. United States Surgical Corp., 1984 HCA 64, 156 CLR 41, ¶¶ 24, 25.

### 22.20.4 Subdivision b.2: Not *every* reasonable action required

This subdivision is a roadblock term, intended to forestall any contention that *best efforts* requires the taking of every conceivable reasonable action — because with 20-20 hindsight, an opposing party's trial counsel and expert witness will surely think of *something* that could have been done but in fact wasn't done, and argue that this means that best efforts weren't used.

> For case law supporting this standard, see the commentary at Section 22.20.10: .

### 22.20.5 Subdivision b.3: No material harming of own interests

This subdivision is likewise a roadblock term — again, see the commentary at Section 22.20.10: for supporting case law.

### 22.20.6 Business context of best-efforts requests

Best-efforts obligations are especially common when one party grants another party *exclusive* rights, for example exclusive distribution rights or an exclusive license under a patent, trademark, or copyright.

> See, e.g., Kevin M. Ehringer Enterprises, Inc. v. McData Servs. Corp., 646 F.3d 321, 325-27 (5th Cir. 2011).

To many business people, it may seem self-evident that when a contract uses the term *best efforts*, it calls for "something more" than mere *reasonable efforts* — otherwise, why bother even saying *best efforts*? That is to say:

- *reasonable efforts* will cover *a range* of possibilities,
- while *best efforts* refers to *somewhere near the top* of that range.

### 22.20.7 A sports analogy: Bring your "A" game

By analogy, to many business people:

- "C" is a passing grade in (U.S.) schools, and is equivalent to reasonable efforts.
- In contrast, *best efforts* means an "A" effort — or in basketball slang, *bring your "A" game, not your "C" game*.

Another analogy:

- On major U.S. highways, the speed-limit signs often include both maximum *and* minimum speeds of (say) 60 mph and 45 mph. Those two speeds establish the upper- and lower bounds of reasonableness.
- Now, suppose that a trucking company were to agree that its driver would use her "best efforts" to drive a shipment of goods from Point A to Point B on such a highway, where drivers must drive between 45 mph and 60 mph.
- In good weather with light traffic, driving at 45 mph might qualify as *reasonable* efforts. But driving at that speed likely wouldn't cut it as *best* efforts.

### 22.20.8 Possible variation: "All reasonable efforts"

A drafter could specify that best efforts requires the diligent making of **all** reasonable efforts. Delaware's supreme court has held, in essence, that this is a synonym for *best efforts*.

> See Williams Cos. v. Energy Transfer Equity, L.P., 159 A.3d 264, 272-73 (Del. 2020).

Relatedly, *all reasonable efforts* is reportedly a common formulation in the UK and Australia as well.

> See generally, e.g., Menelaus Kouzoupis and Margaux Harris, "Best endeavours" vs "reasonable endeavours": Not two sides of the same coin (SHLegal.com 2020); Shawn C. Helms, David Harding, and John R. Phillips, Best Efforts and Endeavours – Case Analysis and Practical Guidance Under U.S. and U.K. Law (JonesDay.com 2007).

A drafter could also add the phrase, *leaving no stone unturned in seeking to achieve the stated objective*; that language derives from an opinion by the supreme court of British Columbia.

> See Atmospheric Diving Systems Inc. v. International Hard Suits Inc., 1994 CanLII 16658, ¶¶ 63, 71-72 (BC SC), 89 B.C.L.R. (2d) 356 (reviewing English and Canadian case law).

Similarly, in Australia, the term *best endeavours* seems to be treated as synonymous with *all reasonable endeavours*;

### 22.20.9 *Best efforts* might mean different things to different courts

Depending on the jurisdiction, a court might not share the view of *best efforts* just described.

• As one court explained, "[c]ontracting parties ordinarily use best efforts language when they are uncertain about what can be achieved, given their limited resources." On the facts of the case, the court affirmed summary judgment that an oil refiner had failed to use its best efforts to meet a commitment, remarking that "[a]s a matter of law, no efforts cannot be best efforts."

CKB & Assoc., Inc. v. Moore McCormack Petroleum, Inc., 809 S.W.2d 577, 581-82 (Tex. App. – Dallas 1990) (affirming summary judgment that defendant had failed to use its best efforts).

• Some — but not all — U.S. courts have seemingly equated *best efforts* with mere *reasonable efforts*, contrary to what business people are likely to think they're getting in a best-efforts clause. As one 2005 review of case law puts it, "For years U.S. courts have used the phrases 'reasonable efforts' and 'best efforts' interchangeably within and between opinions. Where only one of the terms is used, the best-efforts obligation frequently appears indistinguishable from a reasonable-efforts obligation. Some recent cases have gone so far as to equate best efforts and reasonable efforts."

See Scott-Macon Securities, Inc. v. Zoltek Cos., Nos. 04 Civ. 2124 (MBM), 04 Civ. 4896 (MBM), part II-C (S.D.N.Y. May 11, 2005) (citing cases).

(Some of those cases, though, might be interpreted more narrowly as holding merely that a best-efforts obligation does not require the obligated party to make *unreasonable* efforts, while still requiring diligence in the making of *reasonable* efforts.)

• Fortunately, still other U.S. courts seem to have recognized that *best efforts* means something more than merely *reasonable efforts* (such as the Delaware supreme court in its *Williams Cos.* opinion discussed at Section 22.20.8: above).

For example, the Third Circuit held that, at least where the contract involved an exclusive-dealing arrangement, "[t]he obligation of best efforts forces the buyer/reseller to consider the best interests of the seller and itself as if they were one firm."

Tigg Corp. v. Dow Corning Corp., 962 F.2d 1119 (3d Cir. 1992).

Likewise, a Massachusetts appeals court construed the term *best efforts* "in the natural sense of the words as requiring that the party put its muscles to work to perform with full energy and fairness the relevant express promises and reasonable implications therefrom."

Macksey v. Egan, 36 Mass. App. Ct. 463, 472, 633 N.E.2d 408 (1994) (reversing judgment on jury verdict that defendant had breached best-efforts obligation; extensive citations omitted).

Adding to the difficulty, some U.S. courts have held that the term *best efforts* is too vague to be enforceable *unless* the parties agree to some sort of objective standard of performance, "some kind of goal or guideline against which best efforts may be measured …."

Kevin M. Ehringer Enterprises, Inc. v. McData Servs. Corp., 646 F.3d 321, 326 (5th Cir. 2011) (citation omitted).

One court held that "as promptly as practicable" and "in the most expeditious manner possible" were sufficient to meet that requirement.

See Herrmann Holdings Ltd. v. Lucent Technologies Inc., 302 F.3d 552, 559-61 (5th Cir. 2002) (reversing dismissal under Rule 12(b)(6); citing cases).

### 22.20.10 Best efforts ≠ *every conceivable* effort

The Seventh Circuit has noted that "[w]e have found no cases, and none have been cited, holding that 'best efforts' means every conceivable effort …."

> Triple-A Baseball Club Assoc. v. Northeastern Baseball, Inc., 832 F.2d 214, 228 (7th Cir. 1987) (reversing district court holding), *cited in* California Pines Property Owners Ass'n. v. Pedotti, 206 Cal. App. 4th 384, 394, 41 Cal. Rptr. 3d 793 (2012) (affirming trial-court rejection of claim that party had failed to use best efforts).

Likewise, the First Circuit has held that *best efforts* "cannot mean everything possible under the sun[.]"

> Coady Corp. v. Toyota Motor Distributors, Inc., 361 F.3d 50, 59 (1st Cir. 2004) (affirming rejection of dealership's claim that Toyota distributor had failed to use best efforts; citation omitted), *cited in* California Pines Property Owners, 206 Cal. App. 4th at 394.

And a best-efforts obligation "does not require the promisor to ignore its own interests, spend itself into bankruptcy, or incur substantial losses to perform its contractual obligations."

> California Pines Property Owners, 206 Cal. App. 4th at 394 (citations omitted), *citing* Bloor v. Falstaff Brewing Corp., supra, 601 F.2d 609, 613-614 (2d Cir. 1979) (affirming judgment that party had failed to use best efforts).

### 22.20.11 "Every effort" clauses are often interpreted similarly

"When confronted with idiosyncratic contractual language expressing sentiments akin to doing all that one can or 'all that is necessary' to complete a task, Texas courts often interpret such language as requiring 'best efforts'–an expression with a more clearly established meaning and history."

> Hoffman v. L & M Arts, 774 F. Supp. 2d 826, 833 (N.D. Tex. 2011) (citing cases).

"[C]ourts and arbitrators interpreting similar phrases *[the phrase in question was 'every effort']* have determined, like the district court here, that they impose an obligation to make all reasonable efforts to reach the identified end."

> Aeronautical Indus. Dist. Lodge 91 v. United Tech. Corp.., 230 F.3d 569, 578 (2d Cir. 2000) (citations omitted).

### 22.20.12 *Asking for* best efforts can make business sense

Sure, there's some legal uncertainty associated with a best-efforts commitment. But from a business perspective it can make good sense to ask the other side for such a commitment anyway: a party that makes a best-efforts commitment — to the extent that it later thinks about that commitment at all — will at least be aware that it might well have to make more than just routine, day-to-day, "reasonable" efforts. That alone might be worthwhile to the party asking for the commitment.

### 22.20.13 *Agreeing to make* best efforts could lead to trouble

If you commit to a best-efforts obligation, and the other side later accuses you of breaching that obligation, and you can't settle the dispute, then you're likely to have to try the case instead of being able to get rid of it on summary judgment. That's because:

• No matter what you do, if a problem arises, the other side's lawyers and expert witness(es), with 20-20 hindsight, will argue that there were X number of things that you supposedly *could* have done to achieve the agreed goal but didn't, and so you necessarily failed to use "best" efforts, Q.E.D.

• You're unlikely to be able to get *summary* judgment [TO DO: Link to discussion] that you didn't breach the best-efforts obligation. Instead, you're likely to have to go to the trouble and expense of a full trial or arbitration hearing. The judge or arbitrator could well say that the question involves disputed issues of material fact — those issues would have to be resolved by witness testimony and cross-examination about such things as industry practices; the then-existing conditions; etc. According to the rules of procedure in many jurisdictions, that will require a trial and will not be able to be done in a summary proceeding. Your motion for summary judgment is therefore likely to be denied.

• The tribunal, after hearing the evidence, could find that *in fact* you did *not* use your best efforts. If that were to happen, you'd likely have a very hard time convincing an appeals court to overturn that finding.

### 22.20.14 Best-efforts takeaways

• Drafters should try very hard to be as precise as possible in specifying just what goal the best efforts are to be directed to achieving.

• Obligated parties should think long and hard before agreeing to a best-efforts obligation, because in the long run it could prove to be burdensome and expensive.

### 22.20.15 Optional: Further reading about best efforts

See also:

- Tango Clause 22.127 - Reasonable Efforts Definition and its commentary.
- John Pavolotsky, Best efforts clauses – what buyers expect versus how suppliers respond (IACCM.com 2015).
- Shawn C. Helms, David Harding, and John R. Phillips, Best Efforts and Endeavours – Case Analysis and Practical Guidance Under U.S. and U.K. Law (JonesDay.com 2007).
- Jonathan Pink, Making the Best of a Best Efforts Clause (Blogspot.com 2008).
- Janet T. Erskine, Best Efforts versus Reasonable Efforts: Canada and Australia (Lexology.com 2007).
- Aaron Singer, What do "Best Efforts" and "Reasonable Commercial Efforts" mean? (BCRElinks.com 2003).
- David Shine, "Best Efforts" Standards Under New York Law: Legal and Practical Issues, in *The M&A Lawyer*, March 2004, at 15.
- Akash D. Sethi, Derrick Carson, and Brad L. Whitlock, Boilerplate Provisions, 44 Tex. J. Bus. L. 157, 168 & n.37 (2012).

- Kenneth A. Adams, What the Heck Does "Best Efforts" Mean? (adamsdrafting.com 2008). Note: Ken thinks that *best efforts* is in essence a synonym for *reasonable efforts*, and that therefore drafters should abjure the former term in favor of the latter. While Ken does have at least some support in the case law for this position, in my view it amounts to telling business people, with no good reason: *No, you can't do your deal the way* you *want; I'm the lawyer, and you have to do your deal the way* I *want*. To my way of thinking, that oversteps the proper role of a lawyer (or other drafter).
- Kenneth A. Adams, The Fifth Circuit Considers "Best Efforts," (adamsdrafting.com 2011).
- Kenneth A. Adams, "Best Efforts" Under Canadian Law (adamsdrafting.com 2009).

## Clause 22.21 Binding Agreement Declaration

### 22.21.1 Opportunity to consider terms

By entering into the Contract, each party voluntarily acknowledges (see the definition in Clause 22.1) that:

1. The acknowledging party had an opportunity to read and understand the Contract in its entirety,

    including without limitation the Tango Terms provisions incorporated by reference into the Contract; and

2. The acknowledging party had an opportunity to seek clarification of any provision that it did not understand.

*Commentary*

This language addresses the possibility that a party might try to get out of its contractual obligations, or to excuse its breach, by claiming that it was rushed into signing the contract.

### 22.21.2 Opportunity to consult counsel

By entering into the Contract, each party voluntarily acknowledges (see the definition in Clause 22.1) that:

1. in deciding whether to enter into the Contract on the terms stated in it, the acknowledging party had an opportunity to consult licensed legal counsel of its choosing;

2. if the acknowledging party did not consult such counsel, it made an informed, voluntary decision not to do so; and

3. the acknowledging party has not relied, and will not rely, on advice from counsel for any other party.

*Commentary*

In a contract dispute, a party might claim that it misunderstood a contract provision and therefore shouldn't be bound by it. That usually won't be a winning argument — only rarely will unilateral mistake be enough to set aside a contractual obligation — but the argument can still be a time-waster.

So: The acknowledgement in subdivision 1 above states that the parties *have had the opportunity* to consult counsel — it does not say that the parties *have been* represented by counsel, because that might not be true for one or both parties.

This acknowledgement also refers to consultation with counsel when the parties were *entering into* their agreement, not to when they were *negotiating* the agreement (because there might not have been any negotiation).

In subdivision 3 above, the disclaimer of reliance on other parties' counsel can help shield each party's attorneys against later claims, by a disgruntled counterparty, to the effect of, *wait, I thought you were* **my** *lawyer; you had a conflict of interest and didn't disclose it.*

(It can be tempting for disgruntled counterparties to make such accusations: In malpractice lawsuits against attorneys, a standard tactic by plaintiffs' lawyers is to claim that the attorney accused of malpractice had an undisclosed conflict of interest — and that's a claim that's easier for nonlawyer jurors to understand, akin to *They lied!*)

### 22.21.3 Parties' intent

Each party acknowledges that it intends:

1. that it will be bound by the Contract, *except* for provisions, if any, that the Contract clearly identifies as nonbinding;

2. that each other party will rely on the acknowledging party's acknowledgements in this Declaration;

3. that the Contract will bind not just the acknowledging party itself,

but also the acknowledging party's successors and (if any) permitted assigns,

as well as the acknowledging party's heirs and legal representatives, if the acknowledging party is an individual.

*Commentary*

Subdivision 1: For more on *nonbinding* provisions, see Tango Clause 22.97 - Letters of Intent and its commentary.

Subdivision 3: Concerning permitted assigns, see generally Tango Clause 22.11 - Assignment Consent and its commentary.

## Clause 22.22 Blue Pencil Request

IF: A court or other tribunal of competent jurisdiction holds that a provision of the Contract is invalid, void, unenforceable, or otherwise defective;

THEN: The tribunal is respectfully requested (if a court or other governmental body), or directed (if an arbitral tribunal),

to reform the defective provision, if practicable,

to the minimum extent necessary to cure the defect,

while still given effect to the intent of the defective provision.

*Commentary*

A noncompetition covenant or other restrictive provision might contain a "blue-pencil" clause that says, in effect, to a judge: *Your Honor, if you find that this restrictive covenant is unenforceable, then please modify it so that it **is** enforceable*.

As an example, New York courts can engage in blue-penciling of restrictive covenants, as authorized by a landmark Court of Appeals decision, "if the employer *demonstrates* an absence of overreaching, coercive use of dominant bargaining power, or other anti-competitive misconduct, *but* has in good faith sought to protect a legitimate business interest, consistent with reasonable standards of fair dealing …."

> BDO Seidman v. Hirshberg, 93 N.Y.2d 382, 395, 712 N.E.2d 1220, 690 N.Y.S.2d 854 (1999) (reversing refusal to partially-enforce accountant's post-employment restrictive covenant; citation omitted, emphasis added).

But in some other jurisdictions, courts will refuse to engage in blue-penciling of a contract even if contract specifically authorizes it.

For example, the Indiana supreme court vacated a preliminary injunction that enforced a nonsolicitation covenant as modified, in part on grounds that in Indiana, the blue-pencil doctrine permits only *deleting language*, not *adding limitations*: "Indiana courts employ the 'blue pencil doctrine' to revise unreasonable noncompetition agreements. This doctrine, though, is really an eraser." Heraeus Medical, LLC v. Zimmer, Inc., 135 N.E.3d 150, 156 (Ind. 2019).

## Clause 22.23 Board of Directors Definition

*Board of directors* refers to the principal governing body of an organization, such as (without limitation) the board of directors of an American corporation.

*Commentary*

This is a convenience definition, allowing drafters to refer generically to a "board of directors" without having to spell out different variations for, e.g., limited liability companies, foreign organizations, and the like.

## Clause 22.24 Bond Waiver

IF: A party to the Contract sues another party (or demands arbitration), seeking an injunction, restraining order, specific performance, or other equitable relief against the other party, on grounds that the other party is (or imminently will be) violating the Contract;

THEN: The other party WAIVES (see the definition in Clause 22.162) any requirement that the seeking party must post a bond as a prerequisite to such relief.

*Commentary*

*22.24.0.1 Legal background*

This Waiver comes into play when a plaintiff (or counterplaintiff) seeks a "restraining order" (i.e., preliminary injunctive relief). Under U.S. procedural rules, the court will often — and possibly *must* — require the plaintiff to post payment security, usually in the form of a bond issued by an insurance carrier.

See generally, e.g.: Fed. R. Civ. P. 65(c); Tex. R. Civ. P. 684. Thomas E. Patterson, Handling the Business Emergency, ch.3 (American Bar Association 2009), *excerpted at* http://goo.gl/ak7Mt (books.google.com).

Why is this payment security required? Because:

• When the dust settles, it might turn out that the court shouldn't have granted the preliminary injunction — and that the defendant was harmed by being restrained.

• In that situation, the plaintiff is generally supposed to reimburse the defendant for that harm — but it might also turn out that the plaintiff doesn't have the money to do so.

• So, the point of making the plaintiff put up payment security is to provide some assurance that at least *some* money will be available to reimburse the defendant for the harm it might suffer if it turns out that the preliminary injunction was improvidently granted.

(See generally also Tango Clause 22.119 - Payment Security and its commentary.)

*22.24.0.2 Agreeing to a bond waiver might be a bad idea*

Agreeing to a bond waiver in a contract might be a really bad idea for a party that might be hit with a motion for preliminary injunction. That's because it might turn out: • that the injunction should not have been granted, but • that the claimant, which obtained the wrongfully-granted injunction, doesn't have the money to compensate the respondent for the harm that the claimant caused.

In that situation, without a bond to serve as a backup pot of money, the respondent might never be able to recover damages for its wrongful harm.

(Of course, if the claimant seeking the injunction is, say, CitiBank or ExxonMobil, it's not likely that the claimant wouldn't be able to pay such a damages award, in which case it might be OK to agree to the bond waiver as something akin to a professional courtesy.)

## Clause 22.25 Business Associate Addendum

### 22.25.1 Introduction; parties

This Addendum applies if and when, under the Contract, a specified party ("*Provider*") is to be given access to protected health information ("*PHI*") by another party ("*Customer*").

*Commentary*

In certain circumstances in the U.S., service providers and others that deal with "protected health information" ("PHI") on behalf of a "covered entity" (e.g., health-care providers) must sign a so-called business associate agreement to protect that information; this is required by rules promulgated under HIPAA, the (oddly-named) Health Insurance Portability and Accountability Act of 1996.

See generally, e.g., HIPAA Privacy (HHS.gov).

For speedier legal review (and acceptance), this Addendum is based closely on the sample business associates agreement published by the Department of Health and Human Services on January 25, 2013; some language of the HHS sample agreement has been rephrased for easier reading.

See http://goo.gl/0OYWs, which is a shortened link for a page at www.hhs.gov.

Google's HIPAA Business Associate Addendum seems to be similarly based, with a few variations.

See https://admin.google.com/terms/cloud_identity/3/7/en/hipaa_baa.html.

### 22.25.2 Catch-all definitions from HIPAA Rules

The following terms used in this Addendum have the same meanings as stated in the HIPAA Rules (defined below):—

Breach

Data aggregation

Designated record set

Disclosure

Health care operations

Individual

Minimum necessary (also here)

Notice of privacy practices

Protected health information

Required by law

Secretary *[of Health and Human Services]*

Security incident

Subcontractor

Unsecured protected health information

Use

In addition:

"*Business Associate*" has the same meaning as "business associate" at 45 CFR § 160.103; in this Addendum, the term refers to Provider.

"*Covered Entity*" has the same meaning as "covered entity" at 45 CFR § 160.103; in this Addendum, the term refers to Customer.

"*HIPAA Rules*" refers to the Privacy, Security, Breach Notification, and Enforcement Rules at 45 CFR Part 160 and Part 164.

#### 22.25.3 Provider PHI restrictions

Provider must not use or disclose protected health information other than (i) as permitted or required by the Contract, and/or (ii) as required by law.

#### 22.25.4 Required Provider PHI safeguards

Provider must use appropriate safeguards,

and comply with Subpart C of 45 CFR Part 164 (with respect to electronic protected health information),

to prevent use or disclosure of protected health information other than as provided for by the Contract.

#### 22.25.5 Provider's PHI recordkeeping obligations

Provider must maintain,

and make available to Customer,

the information required to provide an accounting of disclosures as necessary to satisfy Customer's obligations under 45 CFR § 164.528.

#### 22.25.6 Provider's support of Customer's compliance

Provider must comply with the requirements of Subpart E of 45 CFR Part 164 that apply to Customer,

to the extent that Provider is to carry out one or more of Customer's obligation(s) under that subpart.

#### 22.25.7 Inspections by Secretary

Provider must make its internal practices, books, and records available to the Secretary for purposes of determining compliance with the HIPAA Rules.

#### 22.25.8 Required revisions to PHI

a. Provider must:

make any amendment(s) to protected health information in a designated record set as directed or agreed to by Customer pursuant to 45 CFR § 164.526; or

take other measures as necessary to satisfy Customer's obligations under 45 CFR § 164.526.

b. Provider may, at its option, make such amendment(s) or take such other action storing an updated copy of the specific record(s) containing the information being amended,

as opposed to attempting to edit or otherwise update any individual record previously uploaded to Provider's file system by Customer.

### 22.25.9 Provider permitted use and disclosure of PHI

a. Provider may *disclose* protected health information to persons whom Customer has authorized to access Customer's records stored in Provider's file servers.

b. Provider may *use* or *disclose* protected health information as required by law.

c. Provider *may not* use or disclose protected health information in any manner that would violate Subpart E of 45 CFR Part 164 if done by Customer as a covered entity, *except* for the specific uses and disclosures set forth below.

### 22.25.10 Use for proper management / administration

a. Provider may *use* protected health information:

1. for the proper management and administration of Provider, and/or

2. to carry out Provider's legal responsibilities.

b. Provider may *disclose* protected health information (i) for the proper management and administration of Provider, and/or (ii) to carry out the legal responsibilities of Provider, *if* all of the following are true:

1. the disclosures are required by law; or

2. Provider obtains reasonable assurances, from the person to whom the information is disclosed:

A) that the information will remain confidential and be used or further disclosed:

only as required by law,

or for the purposes for which it was disclosed to the person; and

B) that the person will notify Provider of any instances of which the person is aware in which the confidentiality of the information has been breached.

### 22.25.11 Access to persons with approved login credentials

Provider must allow access to protected health information, contained in Customer's files that are maintained on Provider's file-server system, to any person who logs in using login credentials that Customer provided, established, or approved.

### 22.25.12 Provider turnover of PHI to Customer

Provider must make protected health information available to Customer in a designated record set as necessary to satisfy Customer's obligations under 45 CFR § 164.524.

### 22.25.13 PHI subcontractor requirements

Provider must ensure,

in accordance with 45 CFR §§ 164.502(e)(1)(ii) and 164.308(b)(2), as applicable,

that any subcontractors that create, receive, maintain, or transmit protected health information on behalf of Provider

have agreed to the same restrictions, conditions, and requirements that apply to Provider with respect to such information.

### Trouble reports by Provider to Customer

Provider must report to Customer, as required at 45 CFR § 164.410, any use or disclosure of protected health information not provided for by the Contract of which Provider becomes aware, including but not limited to:

a. breaches of unsecured protected health information; and

b. any security incident of which Provider becomes aware.

### 22.25.14 Response to government PHI requests

a. Provider must promptly notify Customer of any demand by a governmental entity for disclosure of personal health information,

to the extent not prohibited by law or otherwise requested by law enforcement.

b. Provider must provide reasonable cooperation with Customer in any attempt by Customer to contest or limit such disclosure.

### 22.25.15 Term of the business associate agreement

The Term of this Addendum is that of the Contract.

*Commentary*

This is a common provision, but some parties might want to specify otherwise.

### 22.25.16 Customer termination for cause

Provider authorizes Customer to terminate this Addendum if Customer determines that Provider:

a. has violated a material term of this Addendum, and

b. has not promptly cured the breach or ended the violation.

### 22.25.17 Post-termination actions by Provider

Provider's obligations under this Addendum to safeguard protected health information that was:—

received from Customer, or

created, maintained, or received by Provider on behalf of Customer,

will survive any termination or expiration of this Addendum.

## Clause 22.26 Business Day Definition

*Business day* refers to a day other than a Saturday; a Sunday; or a holiday on which banks in New York City are generally closed.

(See also the definition of *day* in [NONE].)

*Commentary*

Depending on the country chosen for bank closings, this definition could eliminate a lot of what Americans might think of as work days.

See generally José Sariego, Taking Care of Business (Day) - Defining "Business Day" in Agreements (JDSupra 2020).

## Clause 22.27 Calendar Year Definition

a. *Calendar year* refers to a year according to the Gregorian calendar,

beginning at midnight at the beginning of January 1,

and ending at midnight at the end of the following December 31.

b. An *interval* of a calendar year,

beginning at a specified time on a particular date or following a particular date,

ends at exactly 12:00:00 midnight at the *beginning* of the same date one year afterwards.

EXAMPLE: A period of one calendar year following January 2, 20x5 ends at 12:00:00 midnight at the *beginning* of January 2, 20x6.

*Commentary*

*Subdivision a – Gregorian calendar:* Many parties entering into contracts, even in non-Western countries, will likely operate on the West's conventional calendar; that might not be the case, however, e.g., in Muslim countries.

See generally the blog post and comments at Ken Adams's post, Referring to the Gregorian calendar? (2013).

*Subdivision b – Midnight:* Note the use of "12:00:00 midnight *at the beginning* of the same date …" to remove ambiguity about whether a calendar-year interval ends at the beginning, or at the end, of the anniversary date.

See also midnight (see the definition in Clause 22.104).

## Clause 22.28 Certify Definition

When a party "*certifies*" an assertion relating to the Contract (in a "*certification*" or "*certificate*"), the certifying party does the following:

1. represents (see the definition in Clause 22.134) that the assertion is true;

2. represents that, within a reasonable time before certifying the assertion, the certifying party made a reasonable investigation to confirm that the assertion was true;

3. acknowledges (see the definition in Clause 22.1) that the certifying party intends for another party to the Contract to rely on the certification; and

4. acknowledges that it is reasonable for the other party to rely on the certification for purposes relating to the Contract.

## Clause 22.29 Claim Definition

a. The term *claim*, whether or not capitalized, refers to any request or demand for damages or other relief by an individual or organization, including without limitation a government authority.

b. A claim might be set forth, without limitation:

1. in a written communication such as, for example, a letter or email; and/or

2. in a filing with (or submission to) a tribunal of competent jurisdiction.

*Commentary*

This definition draws on ideas set out in an article by D. Hull Youngblood, Jr. and Peter N. Flocos, Drafting And Enforcing Complex Indemnification Provisions, The Practical Lawyer, Aug. 2010, p. 21, at 27.

When appropriate, drafters should consider specifying *written* claims, to avoid putting a hair trigger on provisions that depend on claims being made, e.g., defense requirements.

## Clause 22.30 Clear and Convincing Evidence Definition

a. *Clear and convincing evidence* of an assertion refers to evidence that is sufficient to produce, in the mind of the factfinder, an abiding conviction that the assertion's truth is highly probable.

b. *Corroboration requirement:* Oral testimony by an interested party, on its own, will not suffice as clear and convincing evidence is not met by statements of individuals and organizations having an interest unless supported by reasonable corroboration (see the definition in Clause 22.38).

*Commentary*

The clear and convincing evidence standard is often required by law for important matters. For example, in many jurisdictions, fraud must be proved by clear and convincing evidence, as compared to the lower, "preponderance of the evidence" standard that normally applies. But it's not unheard-of for contracts to require specific facts to be established by clear and convincing evidence.

> See, e.g., the indemnification agreement quoted in Robert E. Scott and George G. Triantis, Anticipating Litigation in Contract Design, 115 Yale L.J. 814, 867 (2006), at http://perma.cc/R46W-H5JA.

*Subdivision a – language origins:* This definition restates, in somewhat-plainer language, the standard set out by the Supreme Court of the United States.

> See Colorado v. New Mexico, 467 U.S. 310, 316 (1984) (original proceeding); *see also* Ninth Circuit Model Jury Instructions 1.7 (quoting *Colorado*).

*Subdivision b – corroboration requirement:* This language is paraphrased from a Federal Circuit case concerning the need for corroboration of interested testimony about certain patent-related issues, where the court cited a famous 19th-century Supreme Court decision on the subject.

> See TransWeb LLC v. 3M Innovative Properties Co., 812 F.3d 1295, 1301 (Fed. Cir. 2016), *quoting* Washburn & Moen Mfg. Co. v. Beat 'Em All Barbed-Wire Co., 143 U.S. 275, 284 (1892) (The Barbed Wire Patent). See also the commentary to [NONE].

## 22.31 Code of Conduct Limitation

IF: A party agrees to follow another party's code of conduct but fails (in one or more respects) to comply with the code of conduct;

THEN: The other party's EXCLUSIVE REMEDY for the noncompliance *as such* will be to terminate the Contract, but on a going-forward basis only.

*Commentary*

Some customers demand that vendors commit to abiding by their (the customers') codes of conduct. That's often laudable when the codes of conduct concern minimum labor standards, not engaging in illegal or corrupt behavior, and the like.

But vendors understandably push back — not because they want to engage in unethical behavior, but because it's a pain in the [neck] even to read different customers' codes of conduct, let alone try to manage compliance with the different codes' various requirements.

This Limitation gives customers what they often *really* want — namely, the opportunity to publicly throw a vendor under the bus if the customer perceives that the vendor is not complying with the customer's code of conduct — while reducing the operational- and liability burden for the vendor.

In the "THEN" clause, the "noncompliance *as such*" term allows a customer to take other action against a supplier if the action constituting the nomcompliance with the code of was conductfa independently actionable, for example —

• if the noncompliance was independently a(n uncured) breach of the Contract even without regard to the code of conduct; or

• if, say, the supplier defrauded the customer or engaged in other tortious conduct.

## Clause 22.32 Commercially Reasonable Efforts Definition

a. The term "*commercially reasonable efforts*" refers to those efforts that prudent people, experienced in the relevant business, would generally regard as sufficient, in the relevant circumstances, to constitute reasonable efforts.

b. In case of doubt: If the Contract requires a party to make commercially reasonable efforts to do something (referred to as "X"), then the party:

1. need not actually succeed in accomplishing X;
2. need not make all reasonable efforts to accomplish X; and
3. may take its own business interests into account.

### Commentary

#### 22.32.1 Basic purpose

This Definition is intended to "write around" the Delaware supreme court's apparent suggestion that *commercially-reasonable efforts* requires the making of **all** reasonable efforts; it should be read in conjunction with the definitions of *reasonable efforts* ([NONE]) and *best efforts* ([NONE]).

See Williams Cos. v. Energy Transfer Equity, L.P., 159 A.3d 264, 272, text accompanying n.29 (Del. 2020).

### 22.32.2 Business background of *commercially reasonable efforts*

Contract drafters sometimes use the term *commercially reasonable efforts*:

- when they don't want (or don't have time) to impose a specific standard of performance;
- or when the parties simply don't know what the standard *should* be in as-yet undetermined circumstances;
- and to emphasize that the term requires what *business people* would regard as reasonable efforts.

Using the term *commercially reasonable efforts* allows parties to defer (read: dodge) discussing and agreeing to a precise standard for the matter in question. That might well be a safe bet in many cases, because parties usually can amicably resolve any disputes that might arise.

But what if the parties end up disputing whether a party has complied with an obligation to make commercially reasonable efforts? Different courts have applied very different standards, which can lead to uncertainty for businesses about what they're getting into. (W.I.D.D.: When In Doubt, Define!)

### 22.32.3 Commercial reasonableness might lie in *the process*

A party seeking to prove (or disprove) commercial reasonableness of a transaction, contract term, decision, etc., might want to focus on *the process* by which the transaction, etc., came into being. The U.S. Court of Appeals for the Fifth Circuit has said that "Where two sophisticated businesses reach a hard-fought agreement through lengthy negotiations, it is difficult to conclude that any negotiated term placed in their contract is commercially unreasonable."

> West Texas Transmission, LP v. Enron Corp., 907 F.2d 1554, 1563 (5th Cir. 1990) (affirrming district court's refusal to grant specific performance of right of first refusal) (extensive citations omitted).

### 22.32.4 Are *all* reasonable efforts required for "commercially reasonable efforts"?

In a 2017 opinion, the Delaware supreme court held that the term *commercially reasonable efforts* required taking "all reasonable steps" to achieve the stated objective. The court reached this conclusion even though the contract elsewhere used the term *reasonable best efforts*; the principle of *expressio unius, exclusio alterius* might have suggested that the two terms were intended to have different meanings.

> Williams Companies, Inc. v. Energy Transfer Equity, L.P., 159 A.3d 264, 267, 272-73 (Del. 2017) (affirming that party had not breached its efforts obligation).

In a dissent on other grounds, Chief Justice Strine opined that *commercially reasonable efforts* is "a comparatively strong" commitment, one that is only "slightly more limited" than best efforts.

> *Id.* at 276 & n.45 (Strine, C.J., dissenting) (citation omitted).

### 22.32.5 *Prudence* might be the standard for commercially-reasonable efforts

A prudence standard played a role in defining *commercially reasonable efforts* in a major lawsuit between Indiana and IBM over a supposedly-failed project to modernize the state's computer system for administering welfare benefits. Relevantly here: The contract defined *commercially reasonable efforts* as "taking commercially reasonable steps *[circularity, anyone?]* and performing in such a manner as a well managed entity would undertake with respect to a matter in which it was acting in a *determined, prudent*, businesslike and reasonable manner to achieve a particular result." Indiana v. IBM Corp., 4 N.E.3d 696, 716 n.12 (Ind. App. 2014) (rev'g trial court in pertinent part), *aff'd*, 51 N.E.3d 150 (Ind. 2016).

### 22.32.6 May an obligated party take its own interests into account?

A California federal district court, reviewing (sparse) precedent, held that a party obligated to use commercially reasonable efforts could permissibly take into account its own business interests: "Defendant correctly points out that the limited case law regarding the meaning of 'commercially reasonable efforts' is consistent with the principle that commercial practices by themselves provide too narrow a definition and that the performing party may consider its own economic business interests in rendering performance." Citri-Lite Co. v. Cott Beverages, Inc., No. 1:07-cv-01075, slip op. at 45 (E.D. Cal. Sept. 30, 2011) (findings of fact and conclusions of law; citing cases), *aff'd*, No. 11-17609 (9th Cir. Nov. 21, 2013) (unpublished). (Hat tip: Dallas attorney Gary Powell.)

A tangentially related issue arose in a 2014 English case stemming from the financial crisis of 2008: There, Barclays Bank had the right to consent to a particular type of financial transaction, but it was obligated to grant or withhold such consent in a commercially reasonable manner. The England and Wales Court of Appeals rejected Unicredit's argument that this meant that Barclays was required to take *Unicredit's* interests into account, not merely Barclays's own interests. Barclays Bank PLC v. Unicredit Bank AG, [2014] EWCA Civ 302, ¶ 16 (affirming trial-court ruling).

### 22.32.7 "Commercially reasonable": Sensible deferral, or lighting a fuse?

Impatient parties might agree to vague and airy terms such as *commercially reasonable* or *negotiate in good faith* or *use its best efforts* — and those terms could end up being very contentious and expensive to litigate if the parties were unable to agree later.

But that might be the best choice, because they simply might not know what terms they should "carve in stone" in the contract language. This could occur, for example, because the parties don't know (or disagree about) what's even feasible. It could also occur if one or both parties doesn't know what it might want in an actual event.

In some situations like that, it might make sense for the parties to simply defer the discussion, with the intent of working things out later. That could be a very-reasonable calculated risk if the consequences of failing to agree later would be comparatively minor.

Let's look at some considerations that can affect that decision.

- *The "Mack Truck Rule" of contract drafting:* Once upon a time there were two companies that negotiated a very important contract. Each company was represented in the negotiations by a smart, experienced executive who understood the business and also understood the other's company's needs.

During the discussions, the executives hit it off on a personal level. Under pressure to get the deal done, they agreed that they didn't need to waste time on picky details, because they were developing a good working relationship and would surely be able to work out any problems that might arise.

The executives signed the contract and marched off, in great good spirits, to a celebratory dinner. While crossing the street to the restaurant, they were hit by a truck.

Their successors turned out to be idiots who hated each other. Imagine how much fun they had in dealing with the picky details that the faithful departed had left out of the contract.

• *Agree to a* process *instead of an outcome?* When the parties don't know what outcome they want, perhaps they can agree instead to a reasonable *process* that they can use later to decide what the outcome will be. Such a process might include, for example:

- escalation of any disagreement to upper management (see [NONE])
- micro-arbitration — possibly using baseball-arbitration procedures, see [NONE] — and perhaps with a partial-retrial option. [TO DO]

## Clause 22.33 Computer System Access

*See also [PH]*

### 22.33.1 Introduction; applicability

This Clause applies when, in connection with the Contract:

an individual (the "*User*"),

who is, or is employed by, or is otherwise under the control of, a party to the Contract (the "*Accessing Party*"),

gains access to one or more computers; workstations; networks; email systems; telephone systems; or other similar systems, each of which is referred to generically as "*a System*" or as "*the System*," of another party (the "*Host*").

### 22.33.2 Compliance with Host usage policies

The User must follow any policies governing System access and-usage that the Host timely (see the definition in Clause 22.156) communicates to the User and/or to the Accessing Party.

### 22.33.3 Accurate sign-up information

a. IF: The System requires the User to go through a sign-up process for access; THEN: The User must:

1. provide complete and accurate information in response to requests made in the sign-up process; and

2. timely update the information if it changes.

b. IF: The System or the Host asks the User to furnish evidence of identity; THEN: The evidence furnished must be authentic.

c. In determining whether to grant access to the System to the User, the Host is entitled to rely on:

1. the completeness and accuracy of the User's sign-up information; and

2. the authenticity of the User's evidence of identity.

### 22.33.4 User malware protection

Each User must:

1. maintain commercially-reasonable (see the definition in Clause 22.32) protection against malware (see the definition in Clause 22.146.3) for any computer or other device by which the User accesses the System; and

2. take commercially-reasonable measures to prevent malware from being introduced into the System as a result of User's accessing of the System.

### 22.33.5 If password compromise suspected

a. This section applies if the User or Accessing Party suspects that anyone has improperly obtained System login credentials,

whether of the User or of any other user of the System.

b. The User must immediately change the User's password if that User's login credentials are suspected to have been compromised.

c. The User and/or the Accessing Party must promptly notify the Host of the suspected improper obtaining of System login credentials.

d. IF: The Host asks the User and/or the Accessing Party to help the Host investigate and/or remediate the situation,

THEN: The User and the Accessing Party must provide reasonable cooperation in that respect.

### 22.33.6 Prohibited content

Without limiting the User's other obligations under this Clause,

the User must not use the System to transmit or store any of the following:

1. viruses,Trojan horses, bots, crawlers, keystroke recorders, or other malware of any kind;

2. information or other content owned by someone else without the owner's permission;

3. information used or intended to be used:

(i) in any unlawful manner;

(ii) in connection with any unlawful purpose; and/or

(iii) in any manner that in the Host's judgment could expose the Host or any other user of the System to a risk of liability;

4. content that is unlawful, obscene, or offensive,

according to the standards in the geographic community where the User uses the System;

5. content that violates any other acceptable-usage policy that the Host might publish from time to time —

but the Host will give the User and/or the Accessing Party reasonable notice if it does publish such a policy.

### 22.33.7 Other prohibited System uses

Without limiting the User's other obligations under this Clause,

the User must not use the System —

1. in any manner that, in the Host's judgment, unreasonably burdens the System, any network associated with it, or any other network associated with the Host —

    this could include, for example (but not as a limitation), bandwidth usage that the Host judges to be excessive;

2. in any manner that the Host judges to be a nuisance;

3. in any manner that violates the law;

4. in any manner that the User and/or Accessing Party knows (or should know) contributes to violation of the law; or

5. in any manner that the Host judges to be otherwise unreasonable.

### 22.33.8 General prohibitions

Without limiting the User's other obligations under this Clause, the User must not do any of the following:

1. allow anyone else to access or use the System using the User's access credentials; nor

2. use someone else's credentials to access the System; nor

3. otherwise impersonate anyone else in connection with the System; nor

4. establish multiple user accounts to engage in one or more actions that would be prohibited by this section —

    without limiting this restriction, if the User's account is temporarily- or permanently suspended, then the User must not create another account to access the System; nor

5. falsely pretend to represent another individual or entity in connection with the System; nor

6. access anyone else's information stored on the System without proper authorization; nor

7. trace any information about, or owned by, any other user of the System —

this prohibition applies, but is not limited to, personal identifying information and financial information of other users; nor

8. engaging "doxxing," that is, publishing or otherwise disseminating information or images (personal or otherwise) about any other user of the System without that other user's specific authorization; nor

9. engage in spoofing, for example, disguising the origin of any transmission that the User sends via the System or any network associated with it; nor

10. interfere with anyone else's use of the System; nor

11. probe or attempt to defeat or bypass any of the following:

(i) security measures of the System or any network associated with the System;

(ii) access-control filters or -blocks imposed by the Host and/or by another User, if any; and/or

(iii) any other mechanism that may be built into the System to enforce limitations such as (for example) time, geography, etc.; nor

12. make, distribute copies of, or create derivative works based on, any content provided via the System, other than:

(i) the Accessing Party's own content, or

(ii) as expressly authorized in writing by the Host or other owner of the content; nor

13. otherwise infringe anyone else's copyright, trademark, trade secret, or other intellectual property right in the course of using the System; nor

14. disassemble, decompile, or otherwise reverse-engineer any aspect of the System; nor

15. use a bot, screen scraper, Web crawler, or similar method to access the System or any content stored at the System; nor

16. otherwise access the System using any method other than the user interface provided by the Host.

### 22.33.9 Attempts and assistance encompassed

Without limiting the User's other obligations under this Clause,

the User and the Accessing Party must not:

1. attempt to do something prohibited by this Clause,

   whether or not the attempt is successful; nor

2. induce, solicit, allow, or knowingly help anyone else

   to do something prohibited by this Clause,

   whether for the User's or Accessing Party's benefit or otherwise.

### 22.33.10 Accessing Party responsibility

The Accessing Party, if any, is jointly responsible with the User for any harm caused by the User's noncompliance with this Clause.

### 22.33.11 No expectation of User privacy on Host System

a. The User acknowledges that the User has no expectation of privacy for the User's communications or information on the System *unless*:

1. applicable law clearly requires otherwise; or
2. the Contract clearly specifies otherwise.

b. The Accessing Party, if any, makes the same acknowledgement that neither does it have any such expectation of privacy.

### 22.33.12 If a User is with the U.S. Government

a. This section applies if the Accessing Party is any department, agency, or other subdivision of the U.S. Government.

b. The System is provided to the Accessing Party as a "commercial item," "commercial computer software," "commercial computer software documentation," and "technical data," as applicable,

as defined in the Federal Acquisition Regulations (FARs) and the Defense Federal Acquisition Regulations (DFARs).

c. IF: The Contract does not meet the U.S. Government's needs;

OR IF: The User or the Accessing Party regards the Contract as being inconsistent in any respect with federal law,

THEN: Both the User and the Accessing Party must immediately discontinue use of the System.

*Commentary*

This section is modeled on a concept shown in Amazon's AWS agreement at https://aws.amazon.com/agreement/.

#### 22.33.13 Monitoring/suspension of User

The Host may, in the Host's sole discretion (see the definition in Clause 22.49), at any time,

1. monitor the User's access to, and activities on, the System; and

2. suspend the User's access to the System at any time, for reasonable cause,

unless the Contract clearly says otherwise.

## Clause 22.34 Confidential Information

#### 22.34.1 Parties: Discloser; Recipient

This Clause refers to the following parties (possibly among others):

*Discloser:*

A party whose Confidential Information (see the definition in Clause 22.34.2) is protected under the Contract; the term refers

to each party unless the Contract unambiguously states otherwise.

*Recipient:*

A party gaining access to Discloser's Confidential Information, including but not limited to protected health information (see the definition in Clause 22.25) (if applicable).

*Commentary*

The law in the U.S. and UK (and many other jurisdictions) provides protection for trade secrets and other confidential information. Consequently:

- Many short- and long-term business dealings begin with confidentiality agreements to allow the parties to check each other out; and
- Many *operational* contracts include confidentiality provisions.

To that end, this Clause sets out widely-used confidentiality terms.

#### *22.34.1.1 Caution: Legal restrictions?*

In some jurisdictions, the law might restrict parties' ability to enter into confidentiality agreements in certain circumstances, e.g., when settling claims of discrimination.

See, e.g., Non-Disclosure Provisions in the Settlement Agreements (Weil.com 2019), archived at https://perma.cc/T95R-MV48.

#### *22.34.1.2 Which party's information is protected?*

One of the first things that parties need to know is: What information is protected by a confidentiality provision? Parties must decide whether their confidentiality agreement will protect:

- just one party's confidential information (a one-way agreement), or
- that of each party (a two-way agreement).

This Clause goes with the latter option, a two-way agreement, as the default position, because:

FIRST: In many cases, a two-way confidentiality agreement that protect's each party's Confidential Information is likely to be signed sooner because it's likely to be more balanced, inasmuch as each negotiator presumably keeps in mind that today's disclosing party might be tomorrow's receiving party or vice versa.

This is an example of the "I cut, you choose" principle; see also [XREF TO NOTES] on "boomerang" clauses.

SECOND: A two-way confidentiality agreement can reduce the future danger of later, unprotected, "afterthought" confidential disclosures *by the receiving party*. With

a one-way agreement, only the (original) disclosing party's information is protected, and so any disclosures by the receiving party might be completely unprotected, resulting in the receiving party's losing its trade-secret rights in its information.

Just such an own-foot-shooting happened to the plaintiff in a Seventh Circuit case: The plaintiff's confidentiality agreement with the defendant protected only the defendant's information. Consequently, said the court, the plaintiff's afterthought disclosures of its own confidential information were unprotected. See Fail-Safe, LLC v. A.O. Smith Corp., 674 F.3d 889, 893-94 (7th Cir. 2012) (affirming summary judgment for defendant).

THIRD: A *two-way* confidentiality agreement might help avoid future embarrassment: Suppose that Alice and Bob agree to a confidentiality procedure that protects only Alice's information. Also suppose that the procedure's terms were strongly biased in favor of Alice.

But now suppose that, at a later date, Alice and Bob decided that they also needed to protect *Bob's* confidential information as well, so that Bob can disclose it to Alice. In that case, with the shoe on the other foot, Alice might not want to live with the obligations that she previously made Bob accept. As a result, Alice might find herself in *a doubly-embarrassing position*:

- First, Alice would be asking Bob to review and agree to a new confidentiality procedure, and having to explain to Bob why Alice wasn't willing to live with the same procedure that she had earlier pressed upon Bob.
- Second, Alice might turn on her original drafter and ask, *Why didn't you do this the right way in the first place, instead of wasting everybody's time?*

So it's often a good idea to insist that any confidentiality procedure be two-way in their effect from the start, protecting the confidential information of both parties.

#### *22.34.1.3 Caution: "Two-way" agreements can still be biased*

An agreement that's *nominally* two-way can still be biased in favor of the drafting party. *Example:* Suppose that a drafter knows that the drafter's client will be *receiving* another party's confidential information but won't be *disclosing* its own confidential information. In that situation:

- The receiving-party drafter might write a "two-way" (quote unquote) confidentiality provision that provides very little protection for *anyone's* confidential information, because that lack of protection won't hurt the drafter's client — *at least not in the short term*.
- The disclosing party would have to review the confidentiality provisions carefully to make sure it contained sufficient protection for the disclosing party's Confidential Information.

Conversely, if only one party will be *disclosing* confidential information, and *that* party is doing the drafting, then the confidentiality provision might contain burdensome requirements that the *receiving* party would have to review carefully.

### 22.34.2 Definition: Confidential Information; trade secret

a. The term *Confidential Information* refers to information maintained by Discloser as to which:

1. Discloser has made, and continues to make, reasonable efforts (see the definition in Clause 22.127) to keep the information secret;

2. the information meets the other eligibility requirements in this Clause or otherwise in the Contract; and

3. the information does not fall within one of the exclusions in [NONE].

Note: As an aid to readers, Confidential Information is sometimes referred to here as "Discloser's Confidential Information."

Concerning *trade secrets*, see [NONE].

a. The term *trade secret* has the meaning defined in the (U.S.) Defend Trade Secrets Act, 18 U.S.C. § 1839(6).

*Commentary*

#### *22.34.2.1 What can qualify as Confidential Information?*

If a party wants to assert legal rights in its confidential information, the party must show that it took reasonable precautions to keep the information secret; such precautions are a *sine qua non* ("without which not") for legal protection of confidential information in the United States and many other jurisdictions.

• For example, in one case, the Seventh Circuit noted pointedly that the party asserting misappropriation of trade secrets had made no effort to preserve the so-called trade secrets in confidence.

> See Fail-Safe, LLC v. A.O. Smith Corp. 674 F.3d 889, 893-94 (7th Cir. 2012) (affirming summary judgment for defendant under Illinois law).

• Similarly, in a Nebraska federal case, the Eighth Circuit agreed with a district court that a trade-secret plaintiff had failed to take reasonable measures:

> > [Plaintiff] shared the information with a third-party contractor without a confidentiality agreement and without other policies or practices for safeguarding secrets. … [Plaintiff] did not take reasonable steps to safeguard its trade secrets. Without such reasonable efforts or measures, there is no secret to protect, and [Plaintiff] cannot maintain a claim under the [Nebraska Trade Secrets Act] or [federal Defend Trade Secrets Act].
>
> Farmers Edge Inc., v. Farmobile LLC, 970 F.3d 1027, 1033 (8th Cir. 2020) (affirming summary judgment in favor of defendant) (cleaned up, formatting altered).

Of course, in any given case, what constitutes "reasonable' secrecy measures will depend on the circumstances. *Fort-Knox security measures aren't necessary* (usually); less-strict security measures might well suffice. As one court remarked:

> … *there always are more security precautions that can be taken*. Just because there is something else that Luzenac could have done does not mean that their efforts were unreasonable under the circumstances. … Whether these [specific] precautions were, in fact, reasonable, will have to be decided by a jury.

Hertz v. Luzenac Group, 576 F.3d 1103, 1113 (10th Cir. 2009) (citations omitted).

#### *22.34.2.2 Pro tip: Three Rules for protecting confidential information*

The present author has long used a three-part rule of thumb for protecting confidential information:

1. *Lock it up — within reason*: Require passwords to access confidential information on computer networks. Keep hard-copy confidential information in locked file cabinets and/or behind locked doors.

2. *Label it — within reason*: When documents contain confidential information, mark the documents as such; failure to do so won't necessarily be fatal, but proper marking is a big help in court. See the discussion of marking in [NONE] and its commentary.

(But don't be The Boy Who Cried Wolf: If you go crazy with the Confidential stamp and mark obviously-nonconfidential information as confidential, that will work against you.)

3. "*Safe sex*": Be choosy, both *to whom* you disclose your own confidential information and *from whom* you accept confidential information of others — and in either case, use "protection" in the form of (i) a confidentiality agreement with terms such as those of this Clause, or (ii) a *nonconfidentiality* agreement making it clear that you have no confidentiality obligations concerning the other party's information.

#### *22.34.2.3 Subdivision b: What is a trade secret?*

Some types of confidential information might have essentially-unlimited useful life — for example (putatively), the recipe for making Coca-Cola® syrup. For that reason, this section provides that specifically-identified trade secrets will indefinitely remain under confidentiality obligations — and in fairness to Recipient, this section also imposes modest additional proof requirements for claims to trade-secret protection, tracking the (U.S.) federal statute that will ordinarily govern.

But just what will qualify as a "trade secret"? This subdivision adopts the definition in the (U.S.) Defend Trade Secrets Act ("*DTSA*"), 18 U.S.C. § 1839(3).

A key feature of that statutory definition is that, for a party to establish that particular confidential information is a trade secret, that party must show that the information "derives **independent economic value**, actual or potential, from not being generally known to, and not being readily ascertainable through proper means by,

another person who can obtain economic value from the disclosure or use of the information[.]"

#### *22.34.2.4 How can you tell whether something's a trade secret?*

The Judicial Council of California's Civil Jury Instructions, 2017 edition, includes a list of factors that jurors may take into account in determining whether particular information has independent economic value, with extensive citations:

> In determining whether [e.g., information] had actual or potential independent economic value because it was secret, you may consider the following:
>
> (a) The extent to which [name of plaintiff] obtained or could obtain economic value from the [e.g., information] in keeping [it/them] secret;
>
> (b) The extent to which others could obtain economic value from the [e.g., information] if [it were/they were] not secret;
>
> (c) The amount of time, money, or labor that [name of plaintiff] expended in developing the [e.g., information];
>
> (d) The amount of time, money, or labor that [would be/was] saved by a competitor who used the [e.g., information];
>
> [(e) [Insert other applicable factors].]
>
> The presence or absence of any one or more of these factors is notnecessarily determinative.

Of course, this will not always be an easy determination to make.

*Example:* A physician in New York failed in her trade-secret claim against her former employer for allegedly misappropriating her trade-secret billing template; the court said: "We further conclude that Dr. Kairam fails to plausibly allege that the template *[to optimize billing]* is a trade secret. She does not allege, for example, how the template derives independent economic value from not being generally known to others …." Kairam v. West Side GI, LLC, No. 19-447-cv, slip op. at part IV (2d Cir. Dec. 9, 2019) (affirming in part dismissal on the pleadings) (nonprecedential summary order).

*Example:* In contrast, a Microsoft Excel spreadsheet for estimating the financial viability of a possible senior living community, known as an underwriting template, was held to qualify: "Even if there are other underwriting templates publicly available, Brightview's template — containing its own nuanced, data-specific formulas and data amassed over twenty-five years in business — is not, *and it likely holds independent value as a secret* …." Brightview Group, LP v. Teeters, No. 19-2774 (D. Md. Feb. 28, 2020) (granting preliminary injunction; emphasis added).

#### *22.34.2.5 Customer lists could be viewed as trade secrets*

Customer lists have been viewed differently by different courts concerning their economic value; some courts have treated such lists as qualifying for protection, others not. Compare, e.g., two cases coincidentally decided on the same day by different federal courts:

• A federal court in Kentucky granted summary judgment in favor of insurance agents who were accused of misappropriating the confidential customer lists of insurance giant Allstate; the court held that on the facts, the customer lists in question were not protectable.

See Allstate Insurance Company v. Hamm, No. 2:17-cv-00049, slip op. (E.D. Ky. Mar. 23, 2020).

• In contrast, on the same date, a federal court in Nevada granted a preliminary injunction against a company that had hired away two sales people from the plaintiff; the court held that "Plaintiff's client information, deployment records, and product pilot programs derive economic value through not being readily available to the public …."

Indep. Tech., LLC v. Otodata Wireless Network, Inc., No. 3:20-cv-00072-RJC-CLB (D. Nev. Mar. 23, 2020).

#### *22.34.2.6 What constitutes "improper means" of ascertaining a trade secret?*

As noted above, the statutory definition of *trade secret* requires the information in question to *not* be "readily ascertainable through proper means …." The statute defines *improper* means, stating that the term:

> (A) includes theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy, or espionage through electronic or other means; and
>
> (B) does not include reverse engineering, independent derivation, or any other lawful means of acquisition ….

18 U.S.C. § 1839(6).

The exception in subdivision (B) echoes the U.S. Supreme Court's famous *Kewanee Oil* opinion: "A trade secret law, however, does not offer protection against discovery by fair and honest means, such as by independent invention, accidental disclosure, or by so-called reverse engineering[.]"

Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470, 476 (1974).

*Breach of a confidentiality agreement* might or might not be considered improper means of acquiring a trade secret:

• A Texas appeals court held that under Texas law, "[a] post-acquisition breach of a confidentiality or nondisclosure agreement … *cannot* support an improper means finding as a matter of law." See Title Source, Inc. v. HouseCanary, Inc., No. 04-19-00044-CV, slip op. at 19 (Tex. App.—San Antonio June 3, 2020) (reversing judgment on jury verdict and remanding for new trial; emphasis added, citations omitted).

• But then two weeks later, the Fifth Circuit held (in an unpublished opinion) that under Texas law, "a breach of a duty to maintain secrecy *is* a way of establishing improper means …." Hoover Panel Systems, Inc. v. HAT Contract, Inc., No. 19-10650, part II (5th Cir. June 17, 2020) (per curiam: reversing and remanding summary judgment in favor of accused misappropriator; unpublished; emphasis added, citations omitted).

A commentator pointed out that the Fifth Circuit's holding in *Hoover Panel* "raises a potential *Erie* concern," in that federal courts sitting in diversity (i.e., the Fifth Circuit) are supposed to apply state law as interpreted by *state* courts. See David Mlaver, Improper Use of Voluntarily Communicated Trade Secrets Sufficient to Maintain Action for Misappropriation in Texas (IPUpdate.com Jul. 1, 2020).

### 22.34.3 Pre-agreement disclosures: Not covered

Information disclosed before the effective date of the Contract is not protected under this Clause unless clearly agreed otherwise in writing.

*Commentary*

In some cases, drafters might want to specify that the term *Confidential Information* encompasses information disclosed *before* the parties signed the contract. This might be appropriate, for example, if the parties are entering into a written confidentiality agreement to confirm an *oral* confidentiality agreement that was made during previous, informal discussions.

### 22.34.4 Parties' dealings *per se*: Not covered

The term *Confidential Information does not* encompass the fact that the parties are dealing with each other *unless* the Contract unambiguously states otherwise.

*Commentary*

#### *22.34.4.1 Business context*

Parties often want the mere fact that they are in discussions to remain confidential, let alone the details of their business dealings. That can present some tricky issues, though, especially in an employment-related agreement. For example:

- In a sales agreement, the vendor might want for the pricing and terms of the agreement to be kept confidential. Otherwise, a buyer for a future prospective customer might say, "*I know you gave our competitor a 30% discount, and I want to show my boss that I can get a better deal than our competitor did, so you need to give me a 35% discount if you want my business.*"
- Conversely, a customer might not want others to know who its suppliers are, possibly because the customer doesn't want its competitors trying to use the same suppliers.
- Likewise, parties to "strategic" contracts such as merger and acquisition agreements very often want their discussions to be confidential. If the word leaks out

that a company is interested in being acquired, that could send its stock price down.

#### *22.34.4.2 Enforceability of confidentiality-of-dealings clauses*

Clauses requiring parties' contract terms to be kept confidential have been enforced. For example, in 2013 the Delaware chancery court held that a party materially breached an agreement by publicly disclosing the agreement's terms in violation of a confidentiality clause, thereby justifying the other party's termination of the agreement.

> See eCommerce Indus., Inc. v. MWA Intelligence, Inc., No. 7471-VCP, part II-A, text accompanying notes 117 et seq. (Del. Ch. Oct. 4, 2013).

BUT: A confidential-dealings clause might not be "material": In a different case, the Supreme Court of Delaware held that in a patent license agreement, a provision requiring the terms of the license to be kept confidential was *not* material, because the gravamen of the contract was the patent license, not the confidentiality provision; as a result, when the licensee publicly disclosed the royalty terms, the patent owner was not entitled to terminate the license agreement for material breach (see the definition in Clause 22.102.2).

> See Qualcomm Inc. v. Texas Instr. Inc., 875 A.2d 626, 628 (Del. 2005) (affirming holding of chancery court).

#### *22.34.4.3 Governmental views to the contrary?*

Governmental authorities might object to confidential-dealings clauses. For example, in employment-agreement forms, confidentiality provisions sometimes call for the employee to keep confidential all information about salary, bonus, and other compensation; the NLRB and some courts have taken the position that such a requirement violates Section 7 of the National Labor Relations Act.

> See generally this Baker Hostetler memo; see also Tango Clause 22.34.16 - Disclosures authorized by law and its commentary, concerning how the [U.S.] Securities and Exchange Commission has taken a similar view about employees' reporting possible criminal violations to government authorities.

#### *22.34.4.4 Be careful what dealings-related disclosures are prohibited*

A mother filed a wrongful death suit against a physician, claiming that the mother's daughter died of a drug overdose while under the physician's care. The parties settled the case, entering into a settlement agreement containing a confidentiality provision — but the confidentiality provision prohibited only disclosing the fact or terms of settlement; it did *not* prohibit the mother from talking about the physician's alleged malpractice.

After signing the settlement/confidentiality agreement, the mother tweeted about the physician's alleged responsibility for patient deaths. The physician sued the

mother for breach of contract and defamation. A Texas court of appeals affirmed summary judgment in favor of the mother, noting that:

> Roane's allegations against Joselevitz were already matters of public record through the filing of her wrongful death lawsuit. Had Joselevitz desired to prevent Roane from speaking further about his treatment of Willens, he could have negotiated that as a term of the Settlement Agreement.

Joselevitz v. Roane, No. 14-18-00172-CV, slip op. at n.3. (Tex. App.–Houston [14th Dist.] Mar. 31, 2020) (affirming summary judgment for defendant mother).

### 22.34.5 Affiliates' information: Not automatically covered

a. In case of doubt: Except as provided in subdivision b, information of Discloser affiliates (see the definition in Clause 22.2) will *not* be deemed Confidential Information under this Clause unless:

1. the Contract specifically says so, and
2. the information is marked as being subject to the Contract,

whether or not Discloser's own information would otherwise need to be marked as Confidential Information under the Contract,

so that the receiving party ("*Recipient*") and its personnel will have fair warning about their obligations concerning the affiliates' information.

b. Otherwise, affiliate information will be deemed Confidential Information under this Clause only if *Discloser* provides it to Recipient as Confidential Information.

*Commentary*

This section strikes a compromise in a situation in which the parties might have diverging interests:

- Discloser might want its affiliates' confidential information to be protected without the affiliates' having to negotiate and sign separate confidentiality agreements with Recipient.
- But Recipient might insist on knowing exactly which companies conceivably might sue the recipient someday for breach of contract and/or misappropriation of trade secrets.

### 22.34.6 Examples of possible Confidential Information

In case of doubt, the term *Confidential Information* includes, without limitation — but only when otherwise eligible — the following categories of information:

1. analyses; compilations; forecasts; interpretations; notes; reports; studies; summaries; and similar materials, prepared by or for Recipient;

2. negative know-how, i.e., knowledge of things that do not work (but only if knowledge of what *does* work also constitutes Confidential Information);

3. the fact that Discloser is using particular nonconfidential information;

4. selections and/or combinations of specific items of information, even if some or all of those items of information, taken individually, would not qualify as Confidential Information;

5. confidential information of third parties that Discloser provides to Recipient — Discloser is deemed to represent (see the definition in Clause 22.134) and warrant to Recipient that Discloser is authorized to make such information available to Recipient; and

6. information protected by privacy law.

*Commentary*

*22.34.6.1 A laundry list of possibly-confidential information*

Some drafters — *not* including the present author — like to include a list of specific types of information that can qualify as Confidential Information, using language such as the following:

> The term *Confidential Information* encompasses, by way of example and not of limitation, the following types of information when the information is otherwise eligible under this Agreement: Algorithms. Audit reports. ||| Biological materials. Business plans. Business records. ||| Circuit records. Commercial information. Compounds. Computer programs. Contracts. Construction records. ||| Data-center designs. Designs. Diagrams. Documents. Draft publications. Drawings. ||| Engineering records. ||| Financial information. Financial projections. Financial statements. Forecasts. Formulas. ||| Hardware items. ||| Ideas. Interpretations. Invention disclosures. ||| Leases. ||| Machine-readable data. Maps. Market projections. Marketing information. Methods. ||| Offers. Operational data. Opinions. ||| Patent applications (when unpublished). Plans. Pricing information. Procedures. Processes. Product development plans. Product information programs. Projections. Proposals. ||| Re-

search data. Research plans. ||| Samples. Server-configuration designs. Source code for computer programs. Specifications. Strategies. ||| Tax bills. Technical information. Technical reports. Technological developments. Test data. Title reports.

#### *22.34.6.2 "Secret sauce" can qualify as Confidential Information*

It's well-established in U.S. law that if a party makes a specific selection or combination of one or more particular items of information, then that selection or combination can qualify as Confidential Information, even if the individual items of information are not confidential. A well-known example is Kentucky Fried Chicken's "secret blend of 11 herbs and spices" (whose key ingredient, according to one source, is white pepper).

For other examples of "secret sauce" confidential information, see:

• AirFacts, Inc. v. de Amezaga, 909 F.3d 84, 88-89, 96-97 (4th Cir. 2018) (proprietary flowcharts showing publicly-available information in a useful form)

• Tewari De-Ox Sys., Inc., v. Mountain States/Rosen, L.L.C., 637 F.3d 604, 613-14 (5th Cir. 2010) (selection and compilation of commonly-known information about meat packing; citing cases)

• Integrated Cash Mgmt. Servs., Inc. v. Digital Transactions, Inc., 920 F.2d 171, 174 (2d Cir. 1990) ("winning combination" of generic software programs)

#### *22.34.6.3 "Negative know-how" can be confidential*

Negative know-how, i.e., knowledge of experimental dead ends, can qualify as a trade secret. Legendary inventor Thomas Edison is widely quoted as saying, "I have not failed. I've just found 10,000 ways that won't work."

BUT: A court might be skeptical of the economic value of knowing the *wrong* answers if the *right* answer has become publicly available. As a federal court explained:

> … the plaintiffs have failed to allege how these negative trade secrets derive independent economic value from not being generally known given the existence of volumes of information publicly available ….
>
> It is difficult to see how *negative* trade secrets consisting of unsuccessful efforts to develop trade secrets and experimental dead ends can have independent economic value when *the end result* of the process, the *positive* trade secrets, have in fact been uncovered.

> Zirvi v. Flatley, 433 F. Supp 3d 448, 465 (S.D.N.Y. 2020) (dismissing complaint with prejudice) (formatting modified; citations omitted).

#### *22.34.6.4 Subdivision 6: Private information*

Concerning protected health information, see the commentary to Tango Clause 22.25 - Business Associate Addendum.

### 22.34.7 Exclusions from Confidential Information

Unless otherwise required by the Contract or by law, the obligations of this Clause do not apply to particular information that is shown to be or to have been, at the relevant time or times, within one or more of the five categories set forth in this section.

a. *Generally-known or -ascertainable:* Confidential Information does not include information that is generally known to,

> or that is ascertainable, without use of improper means — as defined in the (U.S.) Defend Trade Secrets Act, 18 U.S.C. § 1839(6) — by people within the circles that normally deal with that kind of information,
>
> *unless* the information *became* generally-known, or became ascertainable, because Recipient did something — or someone to whom Recipient (directly or indirectly) provided the information did something — that breached Recipient's obligations under this Clause.

1. *Already-known information:* Confidential Information does not include information that was already in Recipient's possession when Discloser first gave Recipient access to the information — but on that point, Recipient must provide reasonable corroboration (see the definition in Clause 22.38) of any statements by interested witnesses.

2. *Information received elsewhere:* Confidential Information does not include information made available to Recipient by a third party: (i) without restriction, and (ii) without breach of an obligation of confidence to Discloser by the third party.

3. *Independently-developed information:* Confidential Information does not include information developed by (or for) Recipient independently,

> without using information of Discloser that was not itself excluded from the definition of Confidential Information —

but here again, Recipient must provide reasonable corroboration of statements by interested witnesses;

4. *Unprotected disclosures to others:* Confidential Information does not include information that Discloser made available to a third party without requiring the third party to agree to confidentiality obligations that, in relevant respects, are substantially similar to those of this Clause.

*Commentary*

*22.34.7.1 Subdivision a: Exclusion of "generally known" information*

The "generally known" phrasing above is a mashup of: • section 1(4)(i) of the U.S. Uniform Trade Secret Act, see https://perma.cc/XK9G-CLJA at 5; and • the UK's 2018 draft regulations implementing the EU Trade Secrets Directive (2016/943); see UK IP Office, Consultation on draft regulations concerning trade secrets at 19 (2018), https://perma.cc/PHT8-DQFJ.

*Publication* is of course one easily-proved way in which allegedly-confidential information can become "generally known." For example: "It is axiomatic that a plaintiff cannot recover for the misappropriation of a trade secret if he revealed that secret in a published patent or patent application."

> Broker Genius, Inc. v. Zalta, 280 F. Supp. 3d 495, 518 (S.D.N.Y. 2017) (denying plaintiff's motion for preliminary injunction) (citations omitted).

As to *improper means*, see the discussion in the commentary at [NONE].

*22.34.7.2 Caution: Don't say "in the public domain"*

It's not a great idea to say that information is excluded because it is in the "public domain," because that term normally refers to information that is available for use by anyone without restriction — and unauthorized *use* of information might violate patent- or (in the case of computer software) copyright laws.

*22.34.7.3 Subdivision b: Information already known*

The exclusion of information already known presents a proof problem: Suppose that a defendant, accused of misappropriating confidential information, asserts that the defendant isn't liable because: *We already knew the information before you gave it to us — so there!* A judge or jury might be rightly skeptical of an unsupported assertion to that effect; consequently, this Clause requires corroboration of claims of prior knowledge.

See also [NONE] for more discussion of the policy underpinnings and supporting precedent concerning corroboration requirements.

**Pro tip:** One way for a receiving party to add credibility to a claim of prior knowledge would be for the receiving party to *notify* the disclosing party promptly when

the disclosing party discloses information already known to the receiving party. That was an actual contractual requirement in one case, but the defendant did not follow that requirement, which contributed to the court's denial of the defendant's motion for summary judgment.

Structured Capital Solutions v. Commerzbank AG, 177 F. Supp. 3d 816, 829-30 (S.D.N.Y. 2016) (Rakoff, J.).

#### *22.34.7.4 Subdivision c: Information received elsewhere*

**Caution:** Recipient will want to watch out for language that omits the words, "to Discloser" from the phrase "without breaching an obligation of confidence." That's because if the third party's obligation of confidence doesn't benefit Discloser, it shouldn't matter whether the third party breached the obligation in providing the information to Recipient.

**Pro tip:** It'd be best to have some kind of documentary evidence to support the above exclusion.

#### *22.34.7.5 Subdivision d: Independently-developed information*

This exclusion category is again pretty standard, but it presents a proof problem much like that of claims of previous knowledge of Confidential Information: An accused misappropriator might have a hard time convincing a judge or jury that it really did *independently* developed the allegedly-misappropriated information.

*Example*: In *Celeritas v. Rockwell*, a federal-court jury in Los Angeles awarded a startup company more than $57 million because the jury found that Rockwell had breached a confidentiality agreement — the jury rejected Rockwell's assertion that its engineers had independently developed the technology in question after having been exposed to the startup company's information. See Celeritas Technologies Ltd. v. Rockwell Int'l, Inc., 150 F.3d 1354 (1998). (Disclosure: The author was part of Rockwell's trial team in that case.)

#### *22.34.7.6 Subdivision e: Unprotected disclosures to others*

This exclusion is sometimes overlooked; it's likely to apply as a matter of law — see the commentary at [NONE] and the discussion of public filings below — but it can't hurt to be explicit about it.

#### *22.34.7.7 Caution: Don't categorically exclude subpoenaed information, etc.*

Drafters should be careful *not* to exclude subpoenaed information from confidential-information status. Doing so could be a big mistake for a disclosing party — a receiving party could later argue that the mere issuance of a third-party subpoena for information, without more, resulted in the subpoenaed information being automatically and permanently excluded from confidentiality status, *even if* a court were to issue a protective order restricting what the third party could do with the information.

The better approach is to state that disclosures in response to compulsory legal process are explicitly *authorized*, as provided in [NONE].

#### *22.34.7.8 Caution: Public filings can destroy secrecy*

Sometimes a receiving party whose shares are (or are to be) publicly traded might feel that it must disclose Confidential Information in its public filings. *Such public disclosure, though, would almost certainly destroy the confidentiality of the information*.

> See, e.g., Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1011-12, esp. text accompanying n.15 (1984) (noting that Environmental Protection Agency's disclosure of Monsanto's pesticide test data would destroy Monsanto's trade-secret rights in the data).

*Example:* A financial firm lost its claim to trade-secret protection for a particular financial strategy because its customer agreement explicitly authorized disclosure "to any and all persons, without limitation of any kind," so as to avoid adverse consequences under U.S. tax law. Structured Capital Solutions v. Commerzbank AG, 177 F. Supp. 3d 816, 832, 833-35 (S.D.N.Y. 2016) (Rakoff, J., granting summary judgment dismissing claim for misappropriation of trade secrets; citing cases).

The mirror-image issue arose in a Delaware case in which Martin Marietta was held to have breached a confidentiality agreement by including Vulcan's confidential information in a public filing with the Securities and Exchange Commission. Martin Marietta Materials, Inc v. Vulcan Materials Co., 56 A.3d 1072, 1147 (Del. Ch. 2012), *aff'd*, 45 A. 3d 148 (Del. 2012) (en banc).

Confidential treatment orders are sometimes available to protect confidential portions of filings with the Securities and Exchange Commission. See generally the Investopedia article.

#### *22.34.7.9 Caution: The law might require confidentiality anyway*

Contractual exclusions from Confidential-Information status might be preempted by law — that is, just because *this Clause* doesn't protect particular excluded information, that would not automatically mean that the information was fair game for Recipient to use or disclose as it pleased. Both disclosing- and receiving parties will want to check out:

- privacy laws concerning (without limitation):
  - protected *health* information, for example under the U.S. Health Insurance Portability and Accountability Act of 1996 ("HIPAA");
  - personal *financial* information, for example under the Gramm-Leach-Bliley Act;
  - personal information in general under:
    - the EU's General Data Protection Regulation (GDPR); and
    - American state laws concerning user privacy such as the recently-enacted California Consumer Privacy Act (CCPA).; see generally the data-privacy commentary at [BROKEN LINK: data-privacy][BROKEN LINK: data-privacy][BROKEN LINK: data-privacy]; and

- export-control laws — *violation of which can result in jail time* — as discussed briefly in Section 14: .

### 22.34.8 Marking: Presumption of confidentiality

a. *Marked information presumed confidential:* Recipient must treat Discloser's information as Confidential Information if the information is marked as such in accordance with this Clause, unless Recipient can show:

1. that one of this Clause's exceptions to the marking requirement applies, or

2. that the information is excluded from Confidential Information status under [NONE].

b. *Prominence of confidentiality markings:* Confidentiality markings are to be in a reasonably-prominent form that is readily readable by humans.

c. *Marking exception for obviously-confidential information:* Recipient must treat Discloser's information as Confidential Information, even if the information is not marked as such, if the information *is* clearly of a type that reasonable people working in the relevant area business would readily recognize as likely to be confidential,

unless Recipient can show that the information is excluded from Confidential Information status under [NONE].

d. *Exception for internal files:* Even if Discloser's information is not marked as Confidential Information, Recipient must still treat the information as such, IF:

1. Discloser made the information available to Recipient *only* by allowing Recipient to have access to Discloser's internal files (hard copy, electronic, etc.); and

2. Discloser did not give Recipient permission to make and/or take away copies of the information.

e. *Special case — trade secrets:* See also the requirement in [NONE] that trade secrets must be claimed as such, in writing, if Discloser wants Recipient's confidentiality requirements not to expire for them.

*Commentary*

*22.34.8.1 Subdivision a: Striking a balance*

This section sets out a *presumption* of confidentiality as an incentive for Discloser to mark its Confidential Information appropriately. That's because *requiring* Discloser to mark Confidential Information, as an absolute prerequisite for protection of the information, can be unduly bureaucratic. This is especially true when it comes to:

- information that's *obviously* confidential; and
- information in Discloser's internal files to which Recipient is given access.

#### *22.34.8.2 Courts pay attention to the absence of marking*

In assessing whether a discloser had *in fact* maintained particular information in confidence, a court very likely will give significant weight to whether the discloser caused the information to be marked as confidential:

• In the Seventh Circuit's *Fail-Safe* case, the court pointedly noted that the plaintiff, Fail-Safe, had not marked its information as confidential; the court affirmed the district court's summary judgment dismissing the plaintiff's claim of trarde-secret misappropriation against water-heating manufacturer A.O. Smith. See Fail-Safe, LLC v. A.O. Smith Corp. 674 F.3d 889, 893-94 (7th Cir. 2012) (applying Illinois law).

• To like effect was another Seventh Circuit case in which the appeals court affirmed a summary judgment that "no reasonable jury could find that nClosures took reasonable steps to keep its proprietary information confidential," and therefore the confidentiality agreement between the parties was unenforceable. See nClosures, Inc. v. Block & Co., 770 F.3d 598, 600 (7th Cir. 2014).

#### *22.34.8.3 Caution: Failure to mark when agreed can be fatal*

A disclosing party's failure to mark its confidential information as such, *when required by a confidentiality agreement* or nondisclosure agreement ("NDA"), can be fatal to a claim of misappropriation of trade secrets or misappropriation of confidential information.

For example, in *Convolve v. Compaq*, the computer manufacturer Compaq (subsequently acquired by Hewlett-Packard) defeated a claim of misappropriation of trade secrets concerning hard-disk technology because the owner of the putative trade-secret information did not follow up its oral disclosures with written summaries *as required by the parties' non-disclosure agreement*. See Convolve, Inc. v. Compaq Computer Corp., 527 Fed. Appx. 910 No. 2012-1074, slip op. at part II.A.2 (Fed. Cir. 2013) (nonprecedential).

#### *22.34.8.4 Caution: Unmarked information might still be confidential by law*

Some categories of information might be confidential by law even without marking. That's because applicable law might independently impose a confidentiality obligation benefiting third parties, regardless of marking. For example, the U.S. Health Insurance Portability and Accountability Act (HIPAA) imposes such obligations in respect of patients' protected health information.

#### *22.34.8.5 Subdivision b: Prominence of marking*

On a "hard copy" of Confidential Information, a confidentiality marking should be visible on the copy itself; for electronically-stored Confidential information, the confidentiality marking should be plainly visible:

- when the information is pulled up on a screen
- preferably, on the tangible medium where the information is stored (e.g., a USB thumb drive); and
- possibly, in the electronic file title — although in some circumstances, "security through obscurity" might weigh *against* including a confidentiality legend in the file title.

#### *22.34.8.6 Subdivision c: Marking exception for obviously-confidential information*

This marking exception is sometimes controversial in negotiation, but it makes business sense — even if it does pose a risk of later disputes about what information does or doesn't qualify for the exception.

#### *22.34.8.7 Subdivision d: Marking exception for confidential internal files*

This subdivision addresses the slightly-tricky situation in which Recipient's people are allowed to look at Discloser's internal files BUT aren't given permission to make notes, take away copies, etc. In such a situation, it might well be burdensome for Discloser to have to go through each of its files to ensure that all confidential information is marked, on pain of losing confidentiality protection.

(There might also later be a he-said, she-said proof problem if a dispute were to arise about whether particular information had in fact been marked.)

### 22.34.9 Catch-up marking period: Ten business days

Recipient must treat Discloser's information as having been marked as Confidential Information,

> even if the information was *not* marked as confidential when Discloser initially made it available to Recipient —
>
> for example, if Discloser initially disclosed the information to Recipient orally, or in a demonstration, or in an unmarked written disclosure —

IF: All of the following are true:

1. within ten business days after that initial, unmarked disclosure, Discloser followed up by sending Recipient a reasonably-detailed writ-

ten summary of the information;

2. the follow-up summary was itself marked as confidential as prescribed in this Clause; and

3. Discloser gave Recipient notice (see the definition in Clause 22.112) that Discloser had sent the follow-up summary, so as to call Recipient's attention to the catch-up marking and leave a paper trail confirming it.

*Commentary*

This section represents another compromise between the opposing interests of Discloser and Recipient:

- Discloser would prefer no marking requirement at all (and that's how this Clause is set up "out of the box");
- Recipient, on the other hand, would prefer that any information disclosed without marking is automatically non-confidential and fair game for Recipient to use or disclose as it sees fit.

This section gives Discloser a limited time in which to do catch-up marking if for some reason Discloser doesn't mark the information when initially disclosed.

### 22.34.10 Recipient's operational obligations

a. *Required Recipient secrecy measures:* Recipient must take prudent measures to prevent unauthorized access to Discloser's Confidential Information by third parties;

those measures are to include, without limitation, at least the same secrecy measures that Recipient takes with respect to its own confidential information of comparable significance.

b. *Restrictions on Recipient's activities:* Recipient must not do any of the following with Discloser's Confidential Information except as unambiguously allowed by the Contract:

1. use the information (see [NONE] for authorizations);

2. disclose the information to others — this includes, without limitation, making it available to others and confirming others' guesses — see [NONE] (disclosures to employees, etc.), [NONE] (subpoenas, etc.) and [NONE] (legally-immune disclosures);

3. copy or otherwise reproduce the information (see [NONE] for authorizations);

4. translate the information, other than to the minimum extent needed for an authorized use or -disclosure;

5. reverse-engineer the information in any manner.

*Commentary*

*22.34.10.1 Subdivision a: Required Recipient secrecy measures*

In a way, the "at least the same secrecy measures" requirement is for Recipient's own protection: If a problem were to occur, the "optics" would not be great if it turned out that Recipient was more-casual about Discloser's confidential information than it was about Recipient's own confidential information.

Discloser's failure to impose secrecy obligations on Recipient can destroy Discloser's claims of secrecy. Here are a few examples where that happened:

• A supplier gave specific price-quote information to a customer without any sort of confidentiality obligation — doing so defeated the supplier's later claim of trade-secret misappropriation against a former employee.

See Southwest Stainless, LP v. Sappington, 582 F.3d 1176, 1189-90 (10th Cir. 2009) (reversing judgment of misappropriation of trade secrets).

• To like effect was a case involving a scientist who sued the U.S. Government for infringing his patents and afor misappropriating his allegedly-secret proprietary information. The court granted the government's motion to dismiss the misappropriation claim, saying: "[I]nstances in which Mr. Gal-Or took proactive steps to protect the confidentiality of his trade secrets are simply *overwhelmed [emphasis in original]* by the number of times he did not. … In sum, because Mr. Gal-Or disclosed trade secrets to others, *who were under no obligation to protect the confidentiality of the information*, Mr. Gal-Or lost any property interest he may have held."

Gal-Or v. United States, No. 09-869C, slip op. at 17 (Ct. Fed. Cl. Nov. 21, 2013) (dismissing plaintiff's trade-secret claims) (emphasis added).

• And in a different case: "[B]ecause Broker Genius regularly disclosed its alleged secrets to each of its customers without notifying them of the information's confidential nature *or binding them to confidentiality agreements*, Broker Genius is unlikely to be able to show that it undertook reasonable measures to protect the secrecy of its alleged trade secrets."

Broker Genius, Inc. v. Zalta, 280 F. Supp. 3d 495, 517-18 (S.D.N.Y. 2017) (denying plaintiff's motion for preliminary injunction) (emphasis added).

• And another: A financial firm lost its claim to trade-secret protection for a particular financial strategy because its customer agreement explicitly authorized disclosure "to any and all persons, without limitation of any kind," so as to avoid adverse consequences under U.S. tax law.

See Structured Capital Solutions v. Commerzbank AG, 177 F. Supp. 3d 816, 832, 833-35 (S.D.N.Y. 2016) (Rakoff, J., granting summary judgment dismissing claim for misappropria-

tion of trade secrets; citing cases).

#### *22.34.10.2 Subdivision b.5 — reverse engineering*

When a party to a confidentiality agreement expects to disclose "hidden" confidential information (for example, computer programs in executable form), that party will often want the confidentiality agreement to prohibit reverse engineering of the hidden information. "Reverse engineering" of a product can take the form, generally, of one or more of:

- disassembling the product to study its design; and/or
- operating the product and observing its behavior, then using that information to try to figure out what's going on inside.

See generally Reverse engineering and Black box (each, Wikipedia.com).

Reverse engineering is normally **not** considered "improper means" for discovering a trade secret (defined at [NONE]). **But**: Courts in the U.S. routinely enforce contractual prohibitions against reverse engineering of confidential information, especially in software, on grounds that a recipient is free to contractually *bargain away* (i.e., waive) its right to engage in reverse engineering.

See, e.g., Davidson & Associates v. Jung, 422 F.3d 630, 639 (8th Cir. 2005), *following* Bowers v. Baystate Technologies, Inc., 320 F.3d 1317, 1323-26 (Fed. Cir. 2003); Meridian Project Sys., Inc. v. Hardin Construction Co., 426 F. Supp. 2d 1101 (E.D. Cal. 2006). See generally Deepa Varadarajan, The Trade Secret-Contract Interface, 103 Iowa L. Rev. 1543, 1568-70 (2018) (discussing contractual elimination of reverse-engineering rights).

### 22.34.11 Authorized uses by Recipient

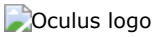
During the term of the Contract, and only then, Recipient may use Discloser's Confidential Information to the extent – and only to the extent — reasonably necessary for one or more of the following:

1. performing Recipient's obligations under the Contract;
2. exercising Recipient's rights under the Contract;
3. assessing whether to enter into another agreement with Discloser; and/or
4. any other use expressly agreed to in writing by Discloser.

*Commentary*

Many confidentiality-agreement forms require the drafter to fill in the "Purpose" for which Recipient is authorized to use Confidential Information. Many of those puropses are pretty standard, so this Clause pre-authorizes some of the most-common ones — while prohibiting other uses unless specifically agreed to.

Recipient might want to state explicitly that that certain other specified uses are authorized as well.




Use of confidential information in violation of a confidentiality agreement (a.k.a. "nondisclosure agreement" or "NDA") can lead to serious consequences. As one example, in 2017, a Dallas jury found virtual-reality company Oculus VR liable for $200 million in damages for breach of an NDA with a video-game company that indirectly owned the games Doom and Quake, among others. (The parties later settled the case.) See generally ZeniMax v. Oculus (Wikipedia.com)

### 22.34.12 Need-to-know disclosure to employees, etc.

During the term of the Contract, Recipient may disclose Discloser's Confidential Information (to the extent not prohibited by law) to Recipient's employees, officers, and directors, to the extent that those individuals:

1. have a legitimate "need to know" in connection with an authorized use- or disclosure of the information by Recipient, and

2. are legally bound by obligations of confidence as provided in [NONE].

*Commentary*

It goes almost without saying that Recipient will need to allow at least some of its employees to access Discloser's Confidential Information — but Discloser will want to put some restrictions on just which Recipient personnel will be eligible (especially if Recipient might be a risk for taking Discloser's information and using it without authorization).

Subdivision 1: Limiting Recipient's disclosures to those having need-to-know is pretty standard in confidentiality provisions.

**Pro tip:** Drafters should consider the extent — if any — to which *Recipient's contractors, affiliates*, etc., should *or should not* be permitted to receive Confidential Information. This will be especially true if Recipient's workforce includes so-called leased employees or other individuals working long-term in independent-contractor status.

### 22.34.13 Confidentiality obligations of other recipients

Before Recipient discloses Confidential Information under [NONE], Recipient must:

1. confirm that each intended recipient is legally bound by confidentiality obligations that are at least as protective of Discloser's Confidential Information as the obligations of the Contract; and

2. take commercially-reasonable steps to cause each such recipient to be specifically instructed and/or reminded that he or she is obliged to abide by those confidentiality obligations in respect of Discloser's Confidential Information.

*Commentary*

This section does *not* require Recipient to obtain *written* confidentiality agreements from Recipient's officers, directors, and employees before making Discloser's Confidential Information available to them. That's because in the U.S., those individuals, by virtue of their positions, will normally be legally bound to preserve *Recipient's* confidential information — and thus, by implication, *Discloser's* Confidential Information — even without a written confidentiality agreement.

For particularly-sensitive Confidential Information, Discloser might want to negotiate for a requirement that Recipient obtain *written* confidentiality agreements from these individuals, and for inclusion of Option 22.34.30 in the Contract.

### 22.34.14 Authorized copying

Recipient may reproduce Discloser's Confidential Information only to the extent reasonably necessary:

1. for a use or disclosure that is authorized by this Clause,

   or that Discloser has otherwise agreed to in writing; and/or

2. for Recipient's normal IT processes — for example, automated backups — that would not pose a significant risk of exposing the reproduced Confidential Information to others in violation of the Contract.

### 22.34.15 Responding to subpoenas, etc.

a. IF: Recipient is served with a subpoena, search warrant, or other compulsory legal demand that calls for Recipient to reveal Discloser's Confidential Information; THEN: Recipient will not be in breach of its obligations under this Clause if Recipient discloses Discloser's Confidential Information as directed by the compulsory legal demand IF Recipient satisfies the following prerequisites:

1. Recipient must give Discloser as much advance notice of the impending disclosure as is allowed by law — but Recipient may use reasonable discretion on that score if a government authority asks Recipient not to notify Discloser.

2. Recipient must provide reasonable cooperation with any effort by Discloser to limit the disclosure in response to the demand.

3. Recipient must not disclose more Confidential Information than is required by law in response to the demand.

b. Discloser will make itself reasonably available to consult with Recipient about proposed other disclosures that the receiving party believes to be required by law (for example, in securities filings), BUT such other disclosures are not authorized unless Discloser specifically agrees otherwise in writing.

*Commentary*

Recipient could find itself in an awkward position if it were served with a civil- or criminal subpoena, or a search warrant demanding that Recipient produce confidential information of Discloser for law-enforcement officials. This section provides a process for Recipient to deal with such a situation.

Subdivision b: *Voluntary* or *discretionary* disclosures of Confidential Information are not allowed, for example in public filings with the Securities and Exchange Commission (SEC). *Example:* In one Delaware case, the court held that Martin Marietta had breached a non-disclosure agreement by including Vulcan's confidential information in an SEC filing about Martin Marietta's proposed takeover of Vulcan.

See Martin Marietta Materials, Inc v. Vulcan Materials Co., 56 A.3d 1072 (Del. Ch. 2012), *aff'd*, 45 A. 3d 148 (Del. 2012) (en banc).

Note: If the parties want to allow in advance for disclosures in public filings, they can consider including Option 22.34.33.

### 22.34.16 Disclosures authorized by law

a. It would not be a breach Recipient's obligations under this Clause if Recipient discloses Discloser's Confidential Information to the minimum extent that:

1. the disclosure would be immune from liability under Title 18, Section 1833(b) of the United States Code, and/or

2. the disclosure is affirmatively authorized by law or regulation, for example the (U.S.) National Labor Relations Act or other applicable labor- or employment law.

b. Recipient is strongly urged — but *not* required — to advise Discloser in advance of any disclosure under this section.

*Commentary*

In the U.S., the law limits the ability of individuals and companies to *restrict* disclosure of confidential information where the restriction would contravene public policy — for example, the (U.S.) Defend Trade Secrets Act, enacted in 2016 and codified at 18 U.S.C. § 1833 et seq.

This legislation followed *fierce* assertions by several U.S. Government agencies that a company may not even arguably discourage, let alone prohibit, the company's employees from disclosing whistleblower information to the agencies. For example:

• In 2015 the Securities and Exchange Commission went after well-known government contractor KBR for warning whistleblowers that they could be fired if they disclosed internal-investigation information with outsiders. KBR agreed to the entry of a cease-and-desist order and to pay $130,000 to settle the matter.

See: SEC press release; SEC order; Houston Chronicle article.

• The (U.S.) National Labor Relations Board has been hostile to contractual confidentiality restrictions that purport to limit employees' discussions of wages and working conditions.

See generally, e.g., Nat'l Labor Rel. Bd. v. Long Island Assoc. for AIDS Care, 870 F.3d 82, 88-89 (2d Cir. 2017) (affirming NLRB ruling).

But note: More recently, Trump appointees to the NLRB appear to be willing to revisit employer-employee confidentiality agreements, at least in the context of settlement- and separation agreements.

See Stephen M. Swirsky, NLRB Board Members Signal Intention to Reconsider Board Law on Confidentiality of Settlement Agreements and to Modify the Board's Blocking Charge "Rule" (NatLawReview.com Jan. 5, 2018).

**Caution:** The NLRB might regard the "it's not a violation" carve-out of this sectioin as insufficiently explaining to employees their right to engage in concerted action under the NLRA.

See the NLRB general counsel's Advice Memorandum dated Nov. 13, 2019, in Case No. 14-CA-227644, concerning a non-disparagement clause in an employment agreement required by the Strange Law Firm, discussed in this law firm memo.

### 22.34.17 Return or destruction: Not required

a. Recipient need not return or destroy Confidential Information unless the Contract unambiguously says so.

b. IF: The Contract unambiguously requires return or destruction of Discloser's Confidential Information;

AND Discloser so requests in writing;

THEN: Recipient must return or destroy copies of Discloser's Confidential Information in accordance with Tango Clause 22.81 - Information Purges except as provided in Tango Clause 22.34.18 - Retention of archive copies.

*Commentary*

Many conventional confidentiality agreements require all copies of confidential information to be returned or destroyed upon termination of the agreement. As discussed below, however, that could be a really bad idea; this section tries to strike a balance.

FIRST: Particularly for electronically-stored information ("ESI"), it could easily prove to be extremely expensive and burdensome for Recipient even to identify, let alone purge, all of Discloser's Confidential Information. That will be especially true if the Confidential Information is stored in a deliverable (for example, custom-developed computer software, or a physical object) that Recipient will have the right to keep on using; this might be the case in a services agreement.

SECOND: Sometimes return- or destruction of confidential information gets overlooked, even when the confidentiality agreement specifically requires it. For example, in one case, "the agreement require[d] a party receiving confidential information to return all confidential information within 30 days of the termination of the agreement. * * * After expiration of the NDA, SiOnyx did not request that Hamamatsu return any confidential information received from SiOnyx, and Hamamatsu did not do so." SiOnyx LLC v. Hamamatsu Photonics K.K., No. 2019-2359, slip op. at (Fed. Cir. Dec. 7, 2020) (affirming judgment after jury verdict of NDA breach):

So, a disclosing party will want to follow up to be sure that a return-or-destruction requirement is actually complied with; if it were to fail to do so, a receiving party (or a third party) could try to use that as evidence that the disclosing party did not take reasonable precautions to preserve the secrecy of its confidential information.

Likewise, if the receiving party were to forget to comply with its return-or-destruction obligations, then the disclosing party might use that fact to bash the receiving party in front of a judge or jury.

**Pro tip:** Consider requiring segregation of Confidential Information, as discussed in Option 22.34.31 — or a recipient could elect to segregate Confidential Information on its own initiative, even without a contractual requirement — for easier compliance with a return-or-destroy requirement.

Subdivision b: Tango Clause 22.81 - Information Purges is adopted here to avoid potential inconsistency with other archive-copy agreements.

### 22.34.18 Retention of archive copies

a. Except as provided in subdivision b, Recipient may keep archive copies of Discloser's Confidential Information in accordance with Tango Clause 22.8 - Archive Copies.

b. IF: Recipient is an employee or individual contractor of Discloser;

THEN: Recipient may not retain copies of Confidential Information,

except solely for the purpose of imminent disclosure under [NONE] *(response to subpoenas, etc.)* or [NONE] *(legally-immune disclosures and disclosures under labor- or employment law)*.

*Commentary*

Recipient will likely want to retain archive copies of Discloser's Confidential Information, if for no other reason than to be able to check those archive copies to confirm — or refute — later claims by Discloser that Recipient was misappropriating information that *allegedly* had been provided to Recipient by Discloser.

### 22.34.19 Continuing confidentiality obligations

In case of doubt: Recipient's confidentiality obligations under the Contract will continue in effect for all copies of Discloser's Confidential Information that are not returned or destroyed.

*Commentary*

This is a "comfort clause" to reassure Discloser and its drafter.

### 22.34.20 Survival of certain obligations

IF: The Contract comes to an end, for example, by being terminated or by expiring;

THEN: Recipient must continue to honor its confidentiality obligations concerning Discloser's Confidential Information;

this is true no matter what other provisions of the Contract (if any) deal with survival of terms.

*Commentary*

See also Tango Clause 22.150 - Survival of terms.

### 22.34.21 Expiration of obligations (*not* for trade secrets)

a. *Expiration for non-trade-secrets:* Except for trade secrets (see [NONE]), Recipient's confidentiality obligations under the Contract will expire at the end of three years after the effective date of the Contract.

b. *No effect on other Discloser rights:* In case of doubt, such expiration of not affect Discloser's right to enforce other rights, such as copyrights and patents, against Recipient.

*Commentary*

#### *22.34.21.1 Why an expiration date ("sunset") is useful*

A Recipient will normally want to stop having to think about confidentiality obligations after a certain period of time — but a Discloser will want confidentiality obligations to continue indefinitely for "trade secrets," i.e., confidential information whose secrecy provides Discloser with an economic advantage. This section and [NONE] represent a compromise between those two concerns.

Some types of confidential information will have a limited useful life, e.g., future plans. Such information might reasonably have its protection limited to X months or years. Recipient might want to ask to establish a "sunset" date for its confidentiality obligations as to those types of confidential information, because:

- After X years have gone by *(from when?)*, it might well be burdensome and expensive for Recipient to figure out (1) which Discloser information is still confidential, and (2) whether Recipient is or isn't using or disclosing Disclosure's *Confidential* Information in violation of the NDA.
- Recipient likely would prefer instead to have a bright-line "sunset" date, after which Recipient can do whatever it wants — other than for Discloser's specifically-identified trade secrets, see [NONE] — without having to incur the above burden and expense.

And Discloser *might* regard an expiration date to be acceptable for non-trade-secret confidentiality obligations, depending largely on:

1. how sensitive the information is, in Discloser's eyes, and
2. how long it will be until the confidentiality obligations expire.

*Example:* Suppose that: • Discloser's Confidential Information in question relates to the design of a Discloser product; and • Discloser knows that, in *two* years, Discloser will be discontinuing the product and will no longer care about the product-design information.

In that situation, Discloser might be willing to have Recipient's confidentiality obligations expire in *three* or *four* years — this would:

- provide Recipient with a bright-line sunset date, and
- provide Discloser with a year or two of safety margin.

#### *22.34.21.2 Caution: Expiration can kill confidentiality rights against others*

If Recipient's confidentiality obligations are allowed to expire automatically in time as provided in this section, then Discloser might thereafter find it difficult — or, more likely, impossible — to convince a court to enforce any confidentiality rights in the relevant information. As Judge Rakoff put it in dismissing a trade-secret claim: "[A] temporary pledge to secrecy is exactly that: temporary. Once a third party's confidentiality obligation … expires, so does the trade secret protection."

Structured Capital Solutions v. Commerzbank AG, 177 F. Supp. 3d 816, 835-36 (S.D.N.Y. 2016) (citing cases).

#### *22.34.21.3 When should the expiration clock start running?*

Drafters could specify that Recipient's confidentiality obligations will expire on the date that occurs X months or years after: • the date that all copies of the information are returned or destroyed, if that is required under the Contract (see [NONE]); or • the effective date of *termination or expiration* of the Contract — but sometimes an agreement won't have an expiration date and the parties might forget to terminate it.

#### *22.34.21.4 Subdivision b: No effect of expiration on other restrictions*

Disclosers sometimes ask for roadblock language of this kind to forestall contrary arguments by Recipient counsel.

### 22.34.22 No confidentiality expiration for trade secrets

a. *Expiration exception:* Recipient's confidentiality obligations will not expire under [NONE] as to trade secrets that Discloser timely claims in writing (see subdivision b.1 below) *until* such time, if any, as the information in question no longer qualifies as a trade secret.

b. *Deadline for written trade-secret claim:* For Recipient's confidentiality obligations to continue in force for a claimed trade secret:

1. Discloser must advise Recipient — in a reasonably-prominent writing and with reasonable particularity — that Discloser regards the information in question as a trade secret; this could include, without limitation, prominently marking the information as a trade secret when the information is first provided to Recipient; and

2. Discloser must do so *before* Recipient's confidentiality obligations would otherwise expire under [NONE].

*Commentary*

This section's requirement that *trade secrets* be explicitly claimed in writing is part of a compromise: it *encourages* parties to mark *all* of their confidential information as such (see [NONE]), but it *doesn't* require marking for garden-variety confidential information that doesn't qualify as a trade secret (for example, because the information lacks independent economic value).

This written-claim requirement also comports with the litigation requirement in some states that a party claiming misappropriation of a trade secret must identify the alleged trade secret with particularity. See, e.g., • Steven D. Gordon, Pre-Discovery Trade Secret Identification Under The DTSA (2019) (reviewing case law), archived at https://perma.cc/2KQV-VZAE; • Jacob W.S. Schneider and Taylor Han, Exploring the Pre-Discovery Trade Secret Identification Requirement in Massachusetts and Across the Country (2018) (reviewing California case law), archived at https://perma.cc/7JLU4ZSG.

The deadline for Discloser to make a written claim to trade-secret status is intended to prevent Discloser from ambushing Recipient with a belated claim at a time when Recipient might have relied on the expiration of Recipient's confidentiality obligations as to the information in question.

### 22.34.23 Cooperation against misappropriators

If Discloser so requests, Recipient will provide reasonable cooperation,

at Discloser's expense,

with any efforts by Discloser to take action:

to protect Discloser's Confidential Information against misappropriation,

and/or to redress such misappropriation and mitigate its effects.

*Commentary*

The "*reasonable* cooperation" qualifier should provide some comfort for a Recipient that thinks it might be opening itself up for burdensome expense in supporting Dis-

closer's protection activities.

### 22.34.24 Restraining orders against misappropriation

a. This section applies in any case in which Recipient discloses or uses Confidential Information other than as provided in the Contract,

or the same is done by an individual or organization to which Recipient disclosed the information.

b. This section will also apply if it appears that such unauthorized disclosure or use is about to happen.

c. In either of the cases described in subdivisions a and b,

Discloser may go to court (or to private arbitration, if that has been agreed to)

to seek an injunction or similar restraining order against Recipient,

and/or against the other individual or organization,

as stated in [NONE].

*Commentary*

This section really just restates the law in the U.S. and UK legal systems, in which one of the major legal weapons available to any party is the right to ask a court to *order* a defendant to stop doing something, which here would be the unauthorized use or disclosure of confidential information. That's a serious remedy — if granted — because if the defendant disobeys the order, it could result in jail time for contempt of court.

(But courts won't grant such orders, which are generally known as *injunctions*, for the asking: The party seeking the order must jump through some hoops to *demonstrate* to the court that certain strict criteria are met, as described in the commentary at [NONE].)

**Language choice:** This section uses the well-known term "restraining order" because it's likely to be more familiar to non-lawyers than "injunctive relief" or "specific performance"; in this context, all of these terms are meant to be more-or-less synonyms.

### 22.34.25 Parties not each others' fiduciaries

In agreeing to this Clause, the parties do not intend it as evidence of, nor as establishing, a "confidential relationship" or "fiduciary relationship" between them, in which either party has fiduciary-like obligations to the other,

*Commentary*

"Confidential" or "fiduciary" relationships can come with major *implied* obligations of uncertain scope; see generally the commentary at [NONE].

### 22.34.26 Option: Recipient Indemnity Obligation

Recipient will defend (as defined in Clause 22.46) Discloser's Protected Group (as defined in Clause 22.126) against any claim, by a third party, arising out of any of the following:

1. Recipient's use of Discloser's Confidential Information, and/or

2. Recipient's disclosure of the Confidential Information to other parties, whether or not as authorized by the Contract.

*Commentary*

As with any indemnity- or defense obligation, Discloser should consider:

- whether Recipient has the financial wherewithal to meet this obligation; and
- whether to ask Recipient also to contractually commit to maintaining appropriate insurance coverage. [TO DO: LINK].

### 22.34.27 Option: Disclosure to Prospective Acquirer

a. *Introduction:* This Option permits disclosure of Discloser's Confidential Information to "*Prospect*," namely:

1. a prospective acquirer of substantially all assets of Recipient's business specifically associated with the Contract; or

2. if Recipient is an organization, a prospective acquirer of substantially all shares of Recipient —

or of equivalent ownership interest under applicable law, if Recipient is an organization that does not have shares; and/or

3. a party (or an affiliate (see the definition in Clause 22.2) of a party) with which Recipient anticipates engaging in a merger, or

similar transaction, in which Recipient would not be the surviving entity.

b. *Prospect's confidentiality agreement:* Prospect must agree in writing with Recipient to abide by Recipient's obligations concerning Discloser's Confidential Information.

1. IF: Discloser learns of Recipient's and Prospect's dealings and requests a copy of Prospect's signed confidentiality agreement with Recipient; THEN: Recipient must promptly comply with Discloser's request.

2. Discloser will be an intended third-party beneficiary of Prospect's agreement with Recipient.

c. *No duty to advise Discloser:* Neither Recipient nor Prospect is required to advise Discloser that they are contemplating a possible transaction.

d. *Permitted disclosure to advisers:* Recipient and Prospect may disclose Discloser's Confidential Information to Prospect's attorneys, accountants, and other advisers that have both:

1. a strong need to know in connection with the possible transaction; and

2. a contractual- and/or fiduciary duty to preserve the information in confidence.

e. *Secure data room:* Any disclosure under this Option must be done:

1. in one or more secure physical data rooms, and/or

2. via a secure online data room.

f. *No copies:* Recipient will not allow or knowingly assist Prospect, nor any of Prospect's recipients under this Option, to keep copies of Discloser's Confidential Information, unless Discloser gives its prior written consent. (*Accessing* information, without more, is not considered keeping a copy of the information.)

*Commentary*

*22.34.27.1 Business background: NDAs and prospective acquirers*

Startups and small companies are sometimes presented with the opportunity for an "exit" by being acquired, typically by a larger company.

- In a merger or acquisition, a company that will be acquired will generally be asked to "open the kimono" to the potential acquiring company, very often by

allowing the acquiring company to access electronic documents in a secure data room.

- When such a company negotiates to receiving another party's confidential inforomation, it should consider whether it might someday want to be able to provide some or all of the information to a prospective acquirer.

This specific provision was inspired by a blog posting by English lawyer Mark Anderson.

**Caution:** It's not unheard of for a big company to approach a small company about being "partners," perhaps hinting that the big company might want to acquire the small company. In that situation, the small company should be alert to the possibility that the big company might be trying to get a free look at the small company's confidential information.

See, e.g., this story told by an anonymous commenter on Hacker News. An NDA can come in very handy in such situations.

*Enforcing* an NDA can take a lot of time and money, especially if the big company is convinced (or convinces itself) that it hasn't done anything wrong — or simply folds its arms and says, *tough [expletive], sue us*.

But a jury might well punish a prospective acquirer if the jury finds that the acquirer used an NDA to get a look at a another company's technology and then walked away. Consider what happened to semiconductor company Rockwell International: • Rockwell signed an NDA to look at a cellular-modem invention that was offered to it by a one-man startup company, Celeritas. • Rockwell's engineers concluded that the Celeritas invention was nothing new and so passed on licensing the invention from Celeritas. • Rockwell developed its own cellular-modem technology — but the Rockwell engineers who developed the technology included individuals who had looked at technical information provided by Celeritas in offering to license the Celeritas invention. • At trial, the startup company argued successfully that Rockwell had not *independently* developed its own technology and thus had violated the NDA; the jury awarded the startup company more than $57 million for breach of the NDA.

See Celeritas Technologies Ltd. v. Rockwell Int'l, Inc., 150 F.3d 1354 (1998) (affirming judgment on that part of the jury verdict but reversing judgment of patent validity and rendering judgment that patent was invalid). *Disclosure:* The author was part of Rockwell's trial team in that case.

Similarly, but not quite on point: A Texas jury awarded more than $730 million in damages to a real-estate data analytics company, HouseCanary, in a lawsuit against a customer, TitleSource, a title-insurance company. • TitleSource had licensed trade-secret valuation models from HouseCanary. • The license agreement included NDA-type provisions that prohibited TitleSource from reverse-engineering HouseCanary's valuation models. • The jury found (in effect) that TitleSource had violated that prohibition in the course of developing TitleSource's own, purportedly-improved valuation model.

See Title Source, Inc. v. HouseCanary, Inc., No. 04-19-00044, slip op. (Tex. App.—San Antonio June 3, 2020). The appeals court reversed and remanded for a new trial for reasons not relevant here.

#### *22.34.27.2 Subdivision d: Disclosure to advisers, etc.*

In most M&A transactions, lots of outside advisers will be involved, but not all will have the need to know required by subdivision d.1.

#### *22.34.27.3 Subdivision e: Disclosure in secure data room(s)*

Data rooms are commonly used in M&A transactions; concerning *online* data rooms, see Virtual data room (Wikipedia.org).

### 22.34.28 Option: Recipient's Compliance Responsibility

IF: A third party obtains or otherwise accesses Discloser's Confidential Information

> as a result of the third party's relationship with Recipient;

and the third party uses, discloses, and/or copies Discloser's Confidential Information in a manner not permitted by the Contract;

THEN:

> Recipient will be liable to Discloser for any resulting harm to Discloser or to Discloser's interests,
>
> to the same extent as if the damage had been caused by Recipient's own use, disclosure, or copying of the Confidential Information.

Note: For this purpose, the term *third party* includes, without limitation, any employee of Recipient.

#### *Commentary*

Recipients might push back if asked to agree to this, but disclosers will usually want "one throat to choke" (a trite but useful expression).

### 22.34.29 Option: Recipient's Assignment-Consent Requirement

Recipient may not assign the Contract without Discloser's written consent.

#### *Commentary*

Consider agreeing to one or more exceptions listed in Tango Clause 22.11 - Assignment Consent.

### 22.34.30 Option: Copies of Confidentiality Agreements

a. If Discloser so requests, Recipient will provide Discloser with a copy of a signed written confidentiality agreement between (i) Recipient and (ii) each individual or organization to which Recipient makes Discloser's Confidential Information available.

b. Each such agreement must obligate the individual or organization, in effect, to give Discloser's Confidential Information the same protection as is required by the Contract.

c. Recipient may have such copies redacted — to a reasonable extent — so that Discloser will not get to see confidential information of Recipient and/or of the individual or organization in question.

*Commentary*

This requirement might be burdensome for Recipient, but sometimes Discloser might have a legitimate need for it.

Subdivision c: The reasonableness requirement for redaction has in mind that some government documents are sometimes supposedly declassified but issued with a risible number of redactions.

### 22.34.31 Option: Segregation Requirement

Recipient must keep Discloser's Confidential Information reasonably segregated from other information, with a view to:

1. providing additional protection of Confidential Information, and

2. speeding up any necessary return or destruction of Confidential Information (if required under [NONE]).

*Commentary*

This segregation requirement could well be unduly burdensome — on the other hand, a segregation requirement might have been useful in a case where an independent oil-and-gas reservoir engineer disclosed trade-secret information to a production company under a nondisclosure agreement. When the relationship waned, the engineer asked for the information to be returned, but that proved problematic, as one individual ended up retaining some of the information in his files.

See S.W. Energy Prod. Co. v. Berry-Helfand, 491 S.W.3d 699, 708 (Tex. 2016).

### 22.34.32 Option: Inspections of Recipient's Compliance

a. Discloser may cause reasonable inspections of Recipient's relevant properties and premises (see subdivision b) to be conducted,

from time to time,

at any time that Recipient has Discloser's Confidential Information in its possession,

to confirm that Recipient is complying with its confidentiality obligations under the Contract.

b. For this purpose, the term "relevant properties and premises" includes, without limitation, any and all relevant hard-copy and electronic records, of any kind, that are in Recipient's possession, custody, or control.

c. Any such inspection must be upon written notice, far enough in advance to be reasonable under the circumstances.

d. Any such inspection must comply with Tango Clause 22.84 - Inspections Protocol.

*Commentary*

Many Recipients are quite likely to balk at this Option; in some circumstances, though, Discloser might feel it was necessary.

### 22.34.33 Option: Disclosure in Public Filings Authorization

a. Recipient may include Discloser's Confidential Information in a submission to a regulatory agency or other governmental body,

but only if all of the prerequisites in this Option are met.

b. The inclusion must be compelled by law to the same extent as if the inclusion were compelled by law in response to a subpoena or other compulsory legal demand, as provided in [NONE].

c. Recipient must first consult with Discloser a sufficient time in advance to give Discloser a reasonable opportunity to seek a confidential treatment order or other comparable relief.

d. Recipient must disclose only so much Confidential Information as is required to comply with the law.

e. Recipient must provide reasonable cooperation with any efforts by Discloser to limit the disclosure,

and/or to obtain legal protection for the information to be disclosed,

in the same manner as if the proposed disclosure were in response to a compulsory legal demand.

*Commentary*

**Caution:** Including Confidential Information in a public filing (for example, a public company's periodic reports filed with the Securities and Exchange Commission) will likely destroy the confidentiality of the information; see the commentary at Section 22.34.7.8: .

### 22.34.34 Option: General Skills Safe Harbor

The Contract's restrictions on Recipient's use of Discloser's Confidential Information do not limit the ability of Recipient's personnel to utilize their general knowledge, skills, and experience in the general field(s) of the Confidential Information,

even if improved by exposure to such information.

*Commentary*

This option is inspired by § 3 of an AT&T nondisclosure agreement (archived at http://perma.cc/G974-2ZH5), which states: "… use by a party's employees of improved general knowledge, skills, and experience in the field of the other party's proprietary information is not a breach of this Agreement."

Caution: This option could be dangerous to Discloser because of the difficulty of determining when the exclusion did or did not apply.

On this point, a court remarked: "This is not to say that Teeters and Dingman cannot use, or advertise, the general knowledge and experience they have gained in their years working in the senior living industry. An employee enjoys a right, in competing against his former employer, to utilize general experience, knowledge, memory and skill — as opposed to specialized, unique or confidential information — gained as a consequence of his employment." Brightview Group, LP v. Teeters, No. 19-2774, slip op. at n.6 (D. Md. Feb. 28, 2020) (granting preliminary injunction) (cleaned up; citation omitted).

### 22.34.35 Option: Residuals-Rights Exclusion

a. Recipient may use "residuals," defined below, as Recipient sees fit, without obligation to Discloser.

b. The term "*residuals*" refers to:

> ideas, concepts, know-how, techniques, and similar information,
>
> that are retained in the unaided memory of Recipient's personnel,
>
> who did not intentionally memorize the information for that purpose.

c. This Option does not negate any restriction of the Contract on Recipient's disclosure of Discloser's Confidential Information to third parties.

d. For the avoidance of doubt, any use of residuals by Recipient will be subject to any applicable patent rights, copyrights, trademark rights, or other intellectual-property ights owned or assertable by Discloser.

*Commentary*

Some receiving parties (*cough*, Microsoft) have sometimes tried to include provisions granting them "residual rights" along the lines of this Option. Such residuals rights could later result in he-said-she-said disputes about whether Recipient's personnel were in fact relying on their *unaided* memories — and that same uncertainty might well tempt Recipient to treat this language as a get-out-of-jail-free card to do whatever it wanted with Discloser's Confidential Information.

For that reason, Discloser likely will push back strongly against any request for residuals rights — or at a minimum, Discloser will try to include carve-outs that exclude particularly-sensitive categories of information, e.g., details of technology; pricing; key personnel; and similar categories.

For more about residuals clauses, see generally, e.g., the following: • Larry Schroepfer, Residuals: License to Steal? (2016); • Tom Reaume, This Residuals Clause Left a Bad Residue (2011); • Scott M. Kline and Matthew C. Floyd, Managing Confidential Relationships in Intellectual Property Transactions: Use Restrictions, Residual Knowledge Clauses, and Trade Secrets, 25 Rev. Litig. 311, 315 et seq. (2006); • Brian R. Suffredini, Negotiating Residual Information Provisions in IT and Business Process Outsourcing Transactions (2004); • Michael D. Scott, Scott on Information Technology Law § 6.25[D] (accessed Nov. 26, 2010); • Brian R. Suffredini, Negotiating Residual Information Provisions in IT and Business Process Outsourcing Transactions (2004).

### 22.34.36 Option: Toolkit Item Exclusion

The term *Confidential Information* does not include:

any concept, idea, invention, strategy, procedure, architecture, or other work,

that is, in whole or in part, created by Recipient as a result of working with Discloser's Confidential Information,

but is not specific, and/or is not unique, to Discloser and its business,

and does not include Discloser's Confidential Information.

*Commentary*

Service providers might want language like this for reasons discussesd in the commentary to Section 22.86.5: .

## Clause 22.35 Consequential Damages Exclusion

a. *Applicability & purpose:* This Clause applies if and when the Contract excludes or otherwise limits "consequential damages" (as defined below), so as to try to avoid disputes between the parties about whether uncommon damages should have been anticipated or foreseen by the party liable for such damages.

b. *Protected persons:* No member of any party's Protected Group (see the definition in Clause 22.126) (each, a "*Protected Party*") will be liable for consequential damages —

even if the Protected Party was in fact advised, or had other reason to know or foresee, of the possibility or even the high probability of such damages,

and regardless of the label given to such damages, such as, for example (see the definition in Clause 22.59), "special damages" —

except as otherwise provided in this Clause or as otherwise agreed in writing.

c. *Definition:* The term *consequential damages* refers to (what could be thought of as) "unexpected" harm arising from a breach of the Contract or other cause, namely:

> the harm was not of a type that *reasonable people* in the relevant business ordinarily would have expected to occur *in the usual course of things* as a result of the breach or other cause;
>
> but *under the particular circumstances* at the time that the liable party entered into the Contract, *the liable party* nevertheless arguably should have anticipated or foreseen the possibility of such harm,
>
> for example (see the definition in Clause 22.59), in cases the liable party was specifically advised of the possibility of such harm.

Commentary

### 22.35.1 The influence of *Hadley v. Baxendale*

The definition of *consequential damages* in this Clause is based on the landmark English case of *Hadley v. Baxendale* (the "corn mill crankshaft case"), which is studied by most if not all American law students. *Hadley* has been much remarked on over the decades; the opinion and its descendants are still relied on in American courts.

See Hadley v. Baxendale, [1854] EWHC Exch J70. See, e.g., • Kreg Therapeutics, Inc. v. VitalGo, Inc., 919 F.3d 405, 418-19 (7th Cir. 2019); • Bi–Econ. Mkt., Inc. v. Harleysville Ins. Co., 10 N.Y.3d 187, 193, 886 N.E.2d 127 (2008); • PNC Bank, Nat. Ass'n v. Wolters Kluwer Financial Servs. Inc., 73 F. Supp. 3d 358, 370 (S.D.N.Y. 2014) (following New York law).

### 22.35.2 "Consequential" vs. "general" damages?

The difference between *consequential damages* and "general" damages can sometimes be unclear. The commentary to the Restatement (Second) of Contracts contrasts the two terms — on the one hand are general damages:

> Loss that results from a breach in the ordinary course of events is *foreseeable as the probable result* of the breach. Such loss is sometimes said to be the "natural" result of the breach, in the sense that its occurrence accords with the common experience of ordinary persons. … The damages recoverable for such loss that results in the ordinary course of events are sometimes called "general" damages.

On the other hand are consequential damages, i.e., *uncommon* or *out-of-the-ordinary* damages:

> If loss results other than in the ordinary course of events, there can be no recovery for it **unless** it was *foreseeable by the party in breach because of special circumstances that he had reason to know* when he made the contract. … The damages recoverable for loss that results other than in the ordinary course of events are sometimes called "special" or "consequential" damages.

> These terms are often misleading, however, and it is not necessary to distinguish between "general" and "special" or "consequential" damages for the purpose of the rule stated in this Section.

Restatement (Second) of Contracts § 351, "Unforeseeability And Related Limitations On Damages," comment b (citations omitted, extra paragraphing added).

The above-quoted Restatement excerpt exemplifies what seems to be a modern trend of collapsing the traditional two-prong formulation of *Hadley v. Baxendale* into a single test: **Should** the claimed damages have been **foreseen** — not by just anyone, **but *by the breaching party*.** Under that test, a way for the plaintiff party to establish that its particular damages were foreseeable *by the breaching party* is for the plaintiff to clearly inform the breaching party, at the time the breaching party became bound by the obligation, about the non-breaching party's particular requirements or circumstances.

See generally, e.g., Thomas A. Diamond & Howard Foss, Consequential Damages for Commercial Loss: An Alternative to Hadley v. Baxendale, 63 Fordham L. Rev. 665, part I-B, esp. n.35 & accompanying text (1994) (reviewing modern approaches to *Hadley*).

In the Uniform Commercial Code, section 2-715(2) defines *consequential damages* as follows:

> Consequential damages resulting from the seller's breach include[:] (a) any loss resulting from general or particular requirements and needs *of which the seller at the time of contracting had reason to know* and which could not reasonably be prevented by cover or otherwise ….

(Emphasis added.)

The UK court of appeals phrased the foreseeability test more plainly: "In essence, D is liable for damage resulting from his breach if, at the time of making the contract, *a reasonable person in D's position* would have had damage of that kind in mind as *not unlikely to result* from a breach[.]" Note the court's use of *not unlikely* as opposed to *likely*.

Wright v. Lewis Silkin LLP, [2016] EWCA Civ 1308 at ¶ 62 (citations omitted).

A different and arguably-stricter approach has been taken by the Supreme Court of Texas, which observed that:

> *Direct* damages are the necessary and usual result of the defendant's wrongful act; they flow *naturally and necessarily* from the wrong…. *Consequential* damages, on the other hand, result *naturally, but not necessarily*. …

El Paso Marketing, L.P. v. Wolf Hollow I, L.P., 383 S.W.3d 138, 144 (Tex. 2012) (internal quotation marks and footnote omitted, alterations by the court, emphasis added), *subsequent proceeding*, 450 S.W.3d 121 (Tex. Nov. 21, 2014) (per curiam — without oral argument, reversing court of appeals's order remanding for new trial on damages).

### 22.35.3 Consequential damages can be big

Noted practitioner-commentator Glenn D. West observes:

> In 1984, an Atlantic City casino entered into a contract with a construction manager respecting the casino's renovation. The construction manager was to be paid a $600,000 fee for its construction management services. In breach of the agreement,

> completion of construction was delayed by several months. As a result, the casino was unable to open on time and lost profits, ultimately determined by an arbitration panel to be in the amount of $14,500,000. There was no consequential damages waiver in the contract at issue in this case.

Glenn D. West, Consequential Damages Redux: An Updated Study of the Ubiquitous and Problematic "Excluded Losses" Provision in Private Company Acquisition Agreements, 70 BUS. L. 971, 984 (Weil.com 2015) (footnote omitted), *citing* Perini Corp. v. Greate Bay Hotel & Casino, Inc., 129 N.J. 479, 610 A.2d 364 (1992) (affirming judgment confirming arbitration award), *abrogated on other grounds by* Tretina Printing, Inc. v. Fitzpatrick & Assocs., Inc., 35 N.J. 349, 640 A.2d 788 (1994) (restricting grounds on which arbitration awards can be reviewed by courts, but stating that parties could expand those grounds by contract).

As another example, a Dr. Kitchen, an Australian opthmalmologist, wrongfully terminated his service agreement with an eye clinic. The service agreement did not include an exclusion of consequential damages. The Supreme Court of Queensland held him held liable for the clinic's lost profits and other amounts, in the total sum of AUD $10,845,476.

See Vision Eye Institute Ltd v Kitchen, [2015] QSC 66, *discussed in* Jodie Burger and Viva Paxton, Australia: A stitch in time saves nine: How excluding consequential loss could save you millions (Mondaq.com 2015).

### 22.35.4 Consequential damages can be hard to identify

Classifying specific damages as consequential or direct might be very subjective exercise. See, e.g., *Indiana v. IBM*, where in a second trial (on remand) over a failed computer-system acquisition:

- The trial judge held that IBM had to pay for a replacement computer system that the state acquired after IBM was fired, known as the "Hybrid" system, even though the Hybrid system was an upgrade from the system that IBM had agreed to build.
- The trial judge held that the additional cost *of the upgrade* was properly classified as *direct* damages resulting from IBM's breach — and thus was subject to an agreed cap of $125 million — and not as *consequential* damages, which would have been subject to a much-lower cap of $3 million.

The trial judge's decision was affirmed on appeal.

See IBM v. Indiana, 112 N.E.3d 1088, 1100-01 (Ind. App. 2018), *summarily aff'd*, 124 N.E.3d 1187, 1189 (Ind. 2019). Dissenting on that issue, a state supreme court judge argued that "it was not IBM's breach but the State's decision to switch to the different, more expensive Hybrid system that caused the State to incur these additional expenses. The State's additional, Hybrid-related costs are at most consequential damages, not direct damages."

*Id.* at 1193 (Slaughter, J., dissenting in part, concurring in part).

For an Internet-age case: In a debatable holding, the New Hampshire supreme court affirmed a trial-court holding that a customer's cost of recreating lost data, necessitated by its outsourcer's alleged mistakes that destroyed the data, were "consequential" and therefore not recoverable because of an exclusion clause in the contract.

See Mentis Sciences, Inc., v. PIttsburgh Networks, LLC, No. 2019-0548, slip op. (N.H. Sept. 22, 2020). Less debatably, the court came out the same way on the customer's claim for damages for

its inability to bid on certain government contracts due to the unavailability of the lost data.

And consider the cases below, in which the damages — assuming there was a breach of some kind — could be significant :

- From USA Today: "Southwest [Airlines] said in a statement that it suspended operations for about 50 minutes early Friday to 'ensure performance' of software systems that were upgraded overnight. The matter didn't cause any flight cancellations, spokeswoman Michelle Agnew said, but early morning flights on the East Coast were delayed by an average of 40 minutes."

- From KHOU.com: "Hill's Pet Nutrition is facing three class action lawsuits after reports of pet deaths after eating dog food with elevated levels of vitamin D. … [The company] said it learned of the problem through a complaint. It said a supplier error was to blame for the elevated vitamin D."

- From a corporate press release: A Taiwan company, TSMC, manufactures computer chips. It recently learned that "a batch of photoresist *[a light-sensitive material used in 'etching' circuits onto chips]* from a chemical supplier contained a specific component which *[sic]* was abnormally treated, creating a foreign polymer in the photoresist." BOTTOM LINE: "This incident is expected to reduce Q1 revenue by about US$550 million …."

Now imagine that you were the supplier that provided the software to Southwest Airlines, or the ingredients to Hill's Pet Nutrition, or the photoresist to the chip manufacturer: How would you like to have to litigate which damages were "direct" and which were "consequential"?

### 22.35.5 Use a damages cap instead?

Some experienced practictioners, including the present author, believe that a more-sensible approach will *often* (not always) be not to bother with an exclusion of consequential damages (because of the difficulties summarized above), and instead to agree to a damages cap, so as to cut the Gordian knot — or to be like Indiana Jones.

### 22.35.6 Consequential damages — list specific examples?

Some drafters — usually *not* including the present author — like to enumerate specific categories of risk for which damages cannot be recovered; this generally entails the drafter's crossing his or her fingers that a court will enforce the enumeration as the drafter hoped.

The following categories have been compiled from various agreement forms **but should be reviewed carefully**, as some could be a bad idea in particular circumstances: • breach of statutory duty; • business interruption; • loss of business or of business opportunity; • loss of competitive advantage; • loss of data; • loss of privacy; • loss of confidentiality *[Editorial comment: This would normally be a* really *bad idea, at least from the perspective of a party disclosing confidential information.]* • loss of goodwill; • loss of investment; • loss of product; • loss of production; • loss of profits from collateral business arrangements; • loss of cost savings; • loss of use; • loss of revenue. For a summary of cases in U.S., English, and Australian courts addressing such "laundry lists," *see* West, Consequential Damages Redux, *supra*, 70 Bus. Lawyer at 987-91.

### 22.35.7 "Lost profits" will often be direct, not consequential, damages

The above laundry list of excluded damages should not be drafted so as to be overly broad for the situation. That's why the lost-profits exclusion in this Clause is phrased as lost profits *from collateral business arrangements*.

New York's highest court, reviewing case law held that, on the facts of a particular case, "lost profits were the direct and probable result of a breach of the parties' agreement and thus constitute general damages" and thus were not barred by limitation-of-liability clause.

> Biotronik A.G. v. Conor Medsystems Ireland, Ltd., 22 N.Y.3d 799, 801-02, 11 N.E.3d 676, 988 N.Y.S.2d 527 (2014). See also: • Tractebel Energy Mktg., Inc. v. AEP Power Mktg., Inc., 487 F.3d 89, 109-110 (2d Cir. 2007) (reversing judgment, after bench trial, denying plaintiff its lost profits); • Thomas H. Warren, W. Jason Allman & Andrew D. Morris, Top Ten Consequential Damages Waiver Language Provisions to Consider (2012); • West, Consequential Damages Redux, *supra*, 70 BUS. L. at 992.

### 22.35.8 Other definitions of *consequential damages*

A different definition of *consequential damages*, one that might *possibly* be more tractable in litigation, is found in North Carolina law: "Consequential or special damages for breach of contract are those claimed to result as a secondary consequence of the defendant's non-performance. They are distinguished from general damages, which are based on *the value of the performance itself, not on the value of some consequence that performance may produce.*"

> Severn Peanut Co. v. Industrial Fumigant Co., 807 F.3d 88, 90-91 (4th Cir. 2015) (cleaned up, emphasis added).

For a stricter definition than that of *Hadley*, see the Texas supreme court's *El Paso Marketing* case, where the court (quoting from an earlier opinion) said that: "Direct damages are the *necessary and usual* result of the defendant's wrongful act; they flow naturally *and necessarily* from the wrong. Consequential damages, on the other hand, result naturally, *but not necessarily.*" This Texas test replaces *Hadley's* "usual course of things" with "*necessary* and usual."

> El Paso Marketing, L.P. v. Wolf Hollow I, L.P., 383 S.W.3d 138, 144 (Tex. 2012) (cleaned up, emphasis added).

### 22.35.9 The Fourth Circuit's lecture to negotiators

The Fourth Circuit 'splained things to customers that negotiate services contracts containing consequential-damages exclusions:

> Companies faced with consequential damages limitations in contracts have two ways to protect themselves.
>
> First, they may purchase outside insurance to cover the consequential risks of a contractual breach, and second, they may attempt to bargain for greater protection against breach from their contractual partner.
>
> Severn apparently did take the former precaution – it has recovered over $19 million in insurance proceeds from a company whose own business involves the contractual allocation of risk.
>
> But it did not take the latter one, and there is no inequity in our declining to rewrite its contractual bargain now.

> Severn Peanut Co. v. Industrial Fumigant Co., 807 F.3d 88, 92 (4th Cir. 2015) (affirming summary judgment in favor of service provider that had caused millions of dollars to its customer's facility) (extra paragraphing added).

### 22.35.10 Caution: Unconscionability?

Courts will sometimes hold that exclusions of consequential damages are "unconscionable." Indeed, UCC § 2-719(3) specifically says:

> Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable.
>
> Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.

(Extra paragraphing added.)

Example: In a Minnesota case about a failed software-installation project, a federal court refused to give effect (at least initially) to a consequential-damages exclusion benefiting the vendor, because the court deemed the exclusion to be unconscionable.

> See Prairie River Home Care, Inc. v. Procura, LLC, No. 17-5121 (D. Minn. Jul. 10, 2019) (denying motion to dismiss claim for consequential damages).

## Clause 22.36 Consumer Price Index / CPI Definition

*Consumer Price Index / CPI*, unless otherwise specified, refers to the Consumer Price Index – All Urban Consumers ("CPI-U"), as published from time to time by U.S. Bureau of Labor Statistics.

*Commentary*

CPI clauses are sometimes included in contracts for ongoing sales or goods or services. Such contracts will typically lock in the agreed pricing for a specified number of years, subject to periodic increases by X% per year (let's say) or by the corresponding increase in CPI, whichever is greater (or sometimes, whichever is *less*).

**Caution:** Depending on the industry, CPI-U might or might not be the best specific index for estimating how much a provider's costs have increased. this is explained in the FAQ page of the Bureau of Labor Statistics.

## Clause 22.37 Contra Proferentem Disclaimer

a. Each party acknowledges (see the definition in Clause 22.1) that the parties were equally responsible for drafting the precise language of the Contract *in its final form*.

b. Each party agrees that any ambiguity in particular language of the Contract is *not* to be interpreted against the party that happened to draft the language solely on that basis — that is, the *contra proferentem* ("against the profferor") principle of contract interpretation is not to be applied.

c. This Clause, however, is not intended to rule out having the language interpreted against the drafting party for other reasons.

Commentary

See the commentary at Section 8.4.2: .

## Clause 22.38 Corroborating Evidence

a. This Clause applies if and when the Contract calls for a factual assertion to be supported by corroborating evidence.

b. The question whether sufficient corroboration has been provided is to be governed by a rule of reason.

c. Corroborating evidence can include, without limitation, documents and testimonial evidence.

d. Each case requiring corroboration is to be decided on its own facts; hard and fast rules will not necessarily apply.

e. Not every detail need necessarily be independently and conclusively supported by corroborating evidence.

*Commentary*

A corroboration requirement takes into account that witnesses might "describe [their] actions in an unjustifiably self-serving manner …. The purpose of corroboration [is] to prevent fraud, by providing independent confirmation of the [witness's] testimony."

Sandt Technology, Ltd. v. Resco Metal & Plastics Corp., 264 F.3d 1344, 1350 (Fed. Cir. 2001) (affirming relevant part of summary judgment; as a matter of law, inventor provided sufficient corroboration of date of invention) (cleaned up).

The U.S. Supreme Court explained the need for corroboration of self-interested statements in a famous 19th-century case concerning a patent for a type of barbed wire. In that case: • an accused patent infringer claimed that someone else was actually the first inventor of the patented barbed wire; BUT • the accused infringer relied solely on oral testimony to support the claim of prior invention.

The Court was not persuaded that the *uncorroborated* testimony rose to the level needed to invalidate the patent in suit:

> We have now to deal with certain unpatented devices, claimed to be complete anticipations of this patent, the existence and use of which are proven only by oral testimony.
>
> In view of the unsatisfactory character of such testimony, arising from the forgetfulness of witnesses, their liability to mistakes, their proneness to recollect things as the party calling them would have them recollect them, aside from the temptation to actual perjury, courts have not only imposed upon defendants the burden of proving such devices, but have required that the proof shall be clear, satisfactory and beyond a reasonable doubt. *[In modern U.S. patent law, such claims must be established by clear and convincing evidence.]*
>
> Witnesses whose memories are prodded by the eagerness of interested parties to elicit testimony favorable to themselves are not usually to be depended upon for accurate information.

Washburn & Moen Mfg. Co. v. Beat 'Em All Barbed-Wire Co., 143 U.S. 275, 284 (1892) (known as *The Barbed Wire Patent* case) (extra paragraphing added). *The Barbed Wire Patent* is quoted in TransWeb LLC v. 3M Innovative Properties Co., 812 F.3d 1295, 1301 (Fed. Cir. 2016), from which the requirements of this Clause are adapted.

## Clause 22.39 Damages Cap General Terms

Commentary

### 22.39.1 Effect of a damages cap

When the Contract imposes a damages cap, whether or not in so many words,

> it means that the maximum amount recoverable is the amount specified in the damages cap.
>
> (See also the "Defined terms" shorthand possibilities in [NONE] below.)

### 22.39.2 Cap as an aggregate amount

A damages cap limits the *aggregate* monetary amount recoverable,

> including but not limited to attorney fees and -expenses,
>
> from any and all liable parties,
>
> in respect of the same claim (or group of related claims).

### 22.39.3 Types of claim affected by cap

A damages cap applies to all claims for:

1. damages of any kind;
2. attorney fees;
3. and other monetary recoveries;

that arise out of, or relate to, breach of the Contract.

### 22.39.4 Different damages caps in different circumstances

The Contract may provide for different damages caps for —

1. different breaches or types of breach;
2. different time periods;

> for example (see the definition in Clause 22.59), different damages caps for before and after X months after the effective date of the Contract;

3. different geographical areas;

and the like.

### 22.39.5 Damages-cap shorthand

The following hypothetical examples are provided to illustrate the meanings of terms that could be used in the Contract:

a. *ABC's liability for breach is capped at 2X*: This means that ABC will not be liable for — and no other party may seek — more than two times the amount paid or payable to ABC.

b. *ABC's liability for breach is capped at 3X on a 12-month lookback*: This means that ABC will not be liable for, and no other party may seek, more than three times the amount that ABC was paid (or was owed), in the 12-month period just before the date that any claimant against ABC knew, or reasonably should have known, of the circumstances giving rise to the claim against ABC.

c. *Damages cap: 2X the total contract value*: This means that neither party will be liable, and no other party may seek, more than two times the total amount to be paid under the Contract, for example (see the definition in Clause 22.59), in fees for services or payment for goods.

## Clause 22.40 Data Privacy Customer Obligations

### 22.40.1 Applicability

This Clause applies if and when a party ("*Customer*") manages personal data of one or more individuals,

using goods, services, or technology furnished — directly or indirectly — by another party ("*Provider*").

### 22.40.2 Customer consent warranty

Customer warrants (see the definition in Clause 22.163),

to Provider's Protected Group (see the definition in Clause 22.126),

that Customer has obtained the consent of each such individual to manage that individual's personal data,

to the extent that such consent is required by applicable law.

### 22.40.3 Customer compliance with privacy laws

Customer must comply at all times with all applicable Privacy Laws (see the definition in Clause 22.124).

### 22.40.4 Customer responsibility for "external" privacy paperwork

Customer acknowledges that applicable Privacy Law (see the definition in Clause 22.124) might require, for example, that Customer:

register as a data controller with a local privacy data office, and/or

pay a fee.

*Commentary*

The EU's General Data Protection Regulation (GDPR) no longer requires "data controllers" to register, but local *national* laws might still impose such requirements.

See generally the resources cited at [BROKEN LINK: data-privacy][BROKEN LINK: data-privacy][BROKEN LINK: data-privacy].

## Clause 22.41 Data Use Authorization

#### 22.41.1 Applicability; parties

This Authorization applies if and when a party ("*Customer*") — directly or indirectly — discloses personal data of one or more individuals to another party ("*Provider*"),

whether or not any such individual is employed by Customer or is a customer or client of Customer.

*Commentary*

**Caution:** Data-privacy law is a big, important topic; see the commentary at [BROKEN LINK: data-privacy][BROKEN LINK: data-privacy][BROKEN LINK: data-privacy].

#### 22.41.2 Authorization

a. Customer agrees that Provider may collect, store, and use such personal data as stated in Provider's privacy policy.

## Clause 22.42 Day Definition

a. *Day* refers to a calendar day, as opposed to a business day (see the definition in Clause 22.26).

b. A period of X days:

1. begins on the specified date, and

2. ends at exactly 12 midnight (see subdivision c concerning time zones) at the *end* of the day on the date X days later.

*Example:* Suppose that a five-day period begins on January 1 — that period ends at exactly 12 midnight at the end of January 6.

c. For purposes of subdivision b, the term *12 midnight* refers:

a. to local time if only one time zone is relevant,

b. otherwise, to the *latest* occurrence of 12 midnight *on the date in question*.

> *Example:* Suppose that both California time and Tokyo time are relevant; in that case, 12 midnight at the end of the day on January 1 refers to 12 midnight at the end of the day on January 1 *in California* (when it would be mid-afternoon on January **2** in Tokyo).

*Commentary*

This "default" definition goes into a bit more detail than most for purposes of precision; drafters are of course free to specify otherwise.

Noe the use of illlustrative examples.

## Clause 22.43 Deadline Definition

a. If the Contract states a deadline *date* marking the end of a specified period,

> but it does not clearly indicate a *time* at which the period ends,
>
> then the period ends at exactly 12 midnight at the *end* of the stated deadline date.

b. The Contract may specify a time zone, as well as a time, for the deadline.

*Commentary*

This definition simply provides a benchmark reference point; using this definition, drafters can precisely specify deadlines as desired.

## Clause 22.44 Deceptive Practices Prohibition

### 22.44.1 Parties bound

Each party (each, an "*Obligated Party*") is bound by this Clause.

*Commentary*

The "each party" configuration of this provision is canary-in-the-coal-mine language: If a prospective obligated party were to balk at it, that might be a red flag.

Some parties might balk at an indemnity obligation, which could be another canary-in-the-coal-mine event.

### 22.44.2 Prohibition

Each Obligated Party, in its dealings with third parties relating to the Contract, must refrain from engaging in any deceptive, misleading, or unethical practice.

*Commentary*

Drafters might also want to include an indemnity- and defense requirement such as the following optional language:

> Each Obligated Party must defend (as defined in Clause 22.46) each other party's Protected Group (as defined in Clause 22.126) against any third-party claim arising out of any alleged violation of this Clause by the Obligated Party.

## Clause 22.45 Defect Correction

### 22.45.1 Introduction; parties

a. This Clause applies if and when a signatory party specified in the Contract, referred to as "*Provider*," is required by the Contract to correct defects in goods or services provided to another party, referred to as "*Customer*."

b. For clarity: The term "*Provider*" is used for convenience, even though the defective goods or services might actually have been provided by another party,

for example (see the definition in Clause 22.59), if a third-party service provider is to deal with defects as stated in this Clause.

*Commentary*

It's quite common for "deliverables" not to meet agreed standards; this Clause sets out a sensible way of handling those situations.

This Clause represents a fairly-standard protocol for correction of *software* defects; it should also be useful in other contexts.

### 22.45.2 Definition: *Defect*

For purposes of this Clause, the term *defect*, whether or not capitalized, refers to any failure,

by one or more deliverables and/or services provided under the Contract,

to comply with agreed written specifications, for example (see the definition in Clause 22.59), in:

the Contract itself; or

an agreed purchase order for goods; or

an agreed statement of work for services.

*Commentary*

The definition of *defect* is fairly standard — notably, it does *not* include a materiality qualifier, because the *materiality* of defects can be addressed in other provisions.

### 22.45.3 Deadline for Customer to report defects

Provider's obligations under this Clause apply only to (purported) defects that Customer reports in writing, to Provider (or Provider's designee), on or before the specified time — 90 days if not otherwise specified — after:

the date of delivery of the relevant deliverable, if the defect is in a deliverable, or

completion of the relevant service,

whichever is applicable.

*Commentary*

Providers will want to establish a cutoff date for their defect-correction obligations.

Customers, of course, will want to make sure that the cutoff date is far enough ahead that defects are reasonably certain to become apparent.

### 22.45.4 Option: Reproducibility prerequisite

a. This Option applies only if clearly so stated in the Contract.

b. Provider's obligations under this Clause apply only to defects that Provider is capable of reproducing by making reasonable efforts.

*Commentary*

Language like this is often included in license agreements for complex software, where the supplier might not be able to reproduce a bug that shows up only in a particular customer's installation.

### 22.45.5 Repair or replacement

a. For any defect that is timely reported under [NONE], Provider is to do one or more of the following:

1. Correct the defect, which may include, without limitation:

   repairing or replacing a defective deliverable, and/or

   re-performing defective services; or

2. deliver a commercially-reasonable workaround for the defect,

   if Provider reasonably determines that correction would be impracticable,

b. Provider is to complete its performance under subdivision a above before the end of 30 days after Provider's receipt of the defect report.

*Commentary*

Subdivision a.2: The concept of a workaround comes from the software world; it might or might not be relevant in other fields.

### 22.45.6 Not a warranty of future performance

In case of doubt: this Clause in itself is not intended as a warranty of future performance of any deliverable, but as a statement of the action(s) that Provider will take if a deliverable fails to comply with a warranty about the state of the deliverable as delivered.

*Commentary*

Drafters and reviewers should note the crucial distinction between:

- a warranty that goods *as delivered* will conform to certain standards, with a cut-off date for the customer to report apparent defects, versus
- a warranty that, for a stated period of time in the future, the goods will conform to certain standards of performance.

This can make all the difference in determining whether a customer has timely filed a lawsuit for breach of warranty, or whether instead the suit is barred under the relevant statute of limitations: In the former case, the limitation period starts at delivery of the allegedly-defective goods.

For more, see the additional discussion at Section 13.6.3: .

### 22.45.7 Refund

If Provider does not timely take the action or actions required by this Clause for a particular defect,

then Provider is to promptly do the following if Customer so requests in writing within a reasonable time:

1. cancel any unpaid invoice calling for payment, by or on behalf of Customer, for those deliverable(s) and service(s), and
2. cause a refund to be made of all amounts paid, by or on behalf of Customer, for the relevant deliverable(s) or service(s),

*Commentary*

This states that Provider is to "cause" a refund to be made; this language anticipates that Customer might have purchased the relevant goods or services via a reseller or other third party.

**Caution:** Providing the right to a refund as a "backup" remedy might be crucial in case other agreed remedies fail, as discussed in the commentary at Section 18.2: .

### 22.45.8 EXCLUSIVE REMEDIES for defects

Provider's obligations stated in this Clause are Provider's only obligations, and the **EXCLUSIVE REMEDIES** available to Customer (or anyone claiming through Customer), for any defect in goods or other deliverables or in services.

*Commentary*

Suppliers are very prone to include exclusive-remedy provisions like this in their terms of sale.

Some drafters might want to provide a schedule of different reporting deadlines for different categories of defect, based on (for example) how long it might take for a particular category of defect to become apparent.

For more on exclusive remedies, see the commentary at Section 18: .

## Clause 22.46 Defense of Third-Party Claims

### 22.46.1 Applicability; parties

This Clause applies if and when, under the Contract, one party ("*Defender*") must defend another party ("*Beneficiary*") against a specified category of claim (see the definition in Clause 22.29).

*Commentary*

Indemnity- and defense obligations in contracts can become especially important if a catastrophic event occurs, such as an oil-well blowout — and if the relevant contract has been *assigned*, things can get even more … interesting.

See, e.g., the contract diagram in Certain Underwriters at Lloyd's, London v. Axon Pressure Prods. Inc., 951 F.3d 248 (5th Cir. 2020), in the aftermath of an oil-well blowout in the Gulf of Mexico.

### 22.46.2 Timely claim alert required

a. *Deadline:* Beneficiary must advise Defender, in writing, of the claim,

on or before ten business days after Beneficiary first learns, by any means, of the claim.

b. *Missed deadline:* IF: Beneficiary is late in advising Defender of a claim as stated in subdivision a;

THEN: Defender must still provide Beneficiary with a defense against the claim;

BUT: Defender may take into account any consequences of the late advice in determining how to conduct the defense and/or to settle the claim.

*Commentary*

*Hypothetical example:* Beneficiary is sued in state court and fails to advise Defender of the suit until after the deadline to remove the case to federal court. In some (harsh) indemnity- and defense provisions — in some insurance policies, for example — Beneficiary loses *any* right to defense or indemnity if Beneficiary does not advise Defender of the claim within a specified time period.

In contrast, this section takes a more-balanced approach.

### 22.46.3 Competent defense required

Defender must provide Beneficiary with a timely, competent, diligent defense against the claim,

by suitably-experienced and reputable defense counsel

reasonably acceptable to Beneficiary.

*Commentary*

The standards of this section are really no more than the general requirements of legal-ethics rules for lawyers.

The "suitably-experienced and reputable defense counsel" language is necessarily vague, but it should serve as a warning that, say, a traffic-ticket lawyer would not necessarily be a sound choice to defend against, say, a bet-the-product-line patent infringement claim.

The "reputable" requirement for defense counsel recognizes that if Defender proposes a specific choice of defense counsel, Beneficiary might not have any way of assessing whether the proposed defense counsel actually know what they're doing; the requirement that the defense counsel be reputable is intended to give Beneficiary some assurance on that point.

### 22.46.4 Defense expenses paid by Defender

Defender must pay for all fees and expenses charged by the defense counsel whom Defender engages to defend Beneficiary against the claim.

*Commentary*

This section does *not* require Defender to pay for other counsel engaged by Beneficiary, but that might be required if the interests of Defender and Beneficiary diverge sufficiently; this possibility is addressed at [NONE]

### 22.46.5 Defender control of defense

For as long as Defender is providing Beneficiary with a defense against the claim in accordance with this Clause, Defender may control the defense — albeit with some exceptions as stated below.

*Commentary*

If Defender *does* provide a defense, then Defender should be able to control the defense — otherwise, the Beneficiary-hired counsel will know it will be Defender, not Beneficiary, that will eventually be paying the bills. That could tempt Beneficiary's counsel to put on an expensive, gold-plated defense that it might not have done otherwise.

(On the other hand, if Defender fails to "step up" to provide Beneficiary with a defense against the claim, then of course *Beneficiary* should be able to control its own defense.)

### 22.46.6 Defender payment of damages, etc.

IF: Any monetary award is entered against Beneficiary in a final judgment from which no further appeal is possible;

THEN: Defender must pay that monetary award unless the Contract clearly says otherwise.

*Commentary*

Note that this commits Defender only to pay monetary awards, *not* to completely indemnify Beneficiary from the consequences of the adverse judgment.

### 22.46.7 If defense not desired

a. This section applies if Beneficiary does not ask Defender to defend against the claim, and even if Beneficiary does not *want* a defense against the claim.

b. IF: Defender elects, in Defender's sole discretion (see the definition in Clause 22.49), to defend Beneficiary against a claim anyway;
THEN:

1. the same terms of this Clause will apply as if Beneficiary had asked for such a defense — including but not limited to restrictions on Beneficiary's actions and Beneficiary's cooperation obligations; and

2. Defender need not reimburse (that is, indemnify) Beneficiary for losses or expenses, of any kind, arising from or relating to the claim, even if the Contract would have otherwise required reimbursement.

*Commentary*

Defender might find it desirable to defend Beneficiary against a claim even if Beneficiary itself is uninterested in the claim or its result. For example, suppose that a third party sues "Customer" for using "Supplier's" products, on grounds that the products supposedly infringe the third party's patent rights. In that situation:

- Supplier might want to defend the claim — even if Customer doesn't care, because it has no "skin in the game" — inasmuch as a judgment in favor of the third party might have adverse consequences for Supplier;
- But in that situation, Supplier shouldn't have to indemnify Customer against possible losses, because Customer turned down the defense.

### 22.46.8 Beneficiary cooperation

a. Beneficiary must provide Defender and Defender's counsel with reasonable cooperation in defending against the claim;

such cooperation must include, without limitation, providing Defender and/or Defender's counsel with all information reasonably requested for the defense.

b. Beneficiary's cooperation obligation under this section applies whether or not Beneficiary asked for a defense against the claim.

c. If Beneficiary so requests in writing, Defender must pay directly, or reimburse Beneficiary for,

all reasonable, out-of-pocket expenses that Beneficiary pays *to third parties* in providing the required cooperation,

but specifically not including, without limitation, any compensation to Beneficiary's own employees;

Defender may require Beneficiary to provide Defender with reasonable supporting documentation for such reimbursable expenses.

*Commentary*

The "reasonably request" language allows some flexibility, which might be appropriate if requested information is subject to, e.g., the attorney-client privilege and the Beneficiary has other reasons for not risking waiver of the privilege by providing the information to Defender's counsel.

### 22.46.9 Beneficiary's use of own monitoring counsel

a. Beneficiary may engage separate counsel to monitor the defense, at Beneficiary's own expense and risk.

b. Defender and Beneficiary must each instruct their respective counsel to provide reasonable cooperation with each other in the defense.

*Commentary*

In many cases where Defender must defend Beneficiary, Defender is likely to want to have its own regular legal counsel be the ones to represent Beneficiary and run the defense.

But Beneficiary might reasonably want Beneficiary's own counsel to keep an eye on what Defender's lawyers are doing — even though, under legal ethics in the U.S.

(and probably in other jurisdictions as well), an attorney's loyalty is to the client, not to a third party that's paying the bills, meaning that Defender's regular legal counsel will owe loyalty to Beneficiary.

### 22.46.10 Beneficiary takeover of the defense

a. IF: Reasonable minds could conclude that Defender's counsel had a conflict of interest;

AND: Under applicable ethics rules, that conflict would preclude Defender's counsel from representing Beneficiary in the defense against the claim;

THEN: Beneficiary may, in its sole discretion (see the definition in Clause 22.49), assume control of the defense and engage separate counsel for the defense.

b. IF: Beneficiary assumes control of the defense under subdivision a; THEN: Defender must reimburse Beneficiary for any reasonable attorney fees (see the definition in Clause 22.16) that Beneficiary incurs in conducting the defense

*Commentary*

Subdivision a is based on standard legal-ethics rules: A lawyer for Party A probably cannot also represent Party B in the same matter if the two parties have conflicting interests.

Also in subdivision a: The language, "If reasonable minds *could* conclude" (emphasis added) is intended to make sure that close calls go in favor of separate counsel.

Cross-reference: [NONE] requires Defender to pay for Beneficiary's defense when *Defender* is controlling the defense.

### 22.46.11 Restrictions on Beneficiary's admissions and waivers

a. IF: Defender is entitled to control Beneficiary's defense; THEN: Beneficiary must not, without Defender's prior written consent:

1. make any non-factual admission or stipulation concerning the claim —

for example, an admission that a third party's patent, being asserted against Beneficiary, was valid and enforceable; nor

2. waive any defense against the claim.

b. IF: Beneficiary does anything prohibited by subdivision a that materially impedes the defense;

THEN: Defender will have no further obligation to Beneficiary, in respect of the claim, by way of either defense or reimbursement.

*Commentary*

Admissions and stipulations to *factual* matters can greatly streamline litigation (and arbitration). *Factual* admissions should be made as required.

EXAMPLE: Suppose that a claimant asked the Beneficiary to admit that, in calendar year 20XX, the Beneficiary sold Y units of the Beneficiary's Model ABC widget; if that were true, then it would make sense for the Beneficiary to simply make the admission.

But if the Beneficiary were to admit, let's say, that the claimant's patent claims were valid and infringed, then that could seriously screw up Defender's defense of the Beneficiary.

### 22.46.12 Defender's (limited) right to control settlement

Defender may settle the claim against Beneficiary at any time that Defender is providing a defense as required by the Contract,

BUT Defender's right to control the settlement is limited by [NONE].

*Commentary*

This control-of-settlement provision is an example of a type of clause that is often found in reimbursement- and defense obligations.

As a particular example: Some categories of insurance contract give the insurance carrier essentially complete control over the settlement of third-party claims. That could cause problems for the protected person if the insurance carrier were to settle a claim but then try to recoup the settlement amount from the protected person. This could happen, for example, if a contractor's surety-bond carrier decided to settle a claim and then sued the contractor to recoup the settlement payment. See, e.g., Hanover Ins. Co. v. Northern Building Co., 891 F. Supp.2d 1019, 1026 (N.D. Ill. 2012) (granting summary judgment awarding damages and attorney fees to insurance company), *aff'd*, 751 F.3d 788 (7th Cir. 2014).

### 22.46.13 Restrictions on Defender's settlement authority

a. Unless Beneficiary gives its prior written consent,

Defender may not settle the claim, and Beneficiary will not be bound by any purported settlement,

if the settlement purports to do any of the following:

1. restrict or place conditions on the Beneficiary's otherwise-lawful activities; or

2. require Beneficiary to take any action,

*other than* making one or more payments of money to one or more third parties,

where Defender fully funds each such payment in advance,

with no recourse against Beneficiary; or

3. encumber any of Beneficiary's assets; or

4. include or require any admission or public statement by Beneficiary; or

5. call for the entry of a consent judgment inconsistent with any of subdivisions 1 through 4 above.

b. Subdivision a does not preclude Defender from settling some aspects of the claim as long as the partial settlement does not entail any of the things listed in subdivisions a.1 through a.5.

*Commentary*

Subdivision a.5: Concerning consent judgments, see the additional reading at [BROKEN LINK: consent-decree-rdg][BROKEN LINK: consent-decree-rdg][BROKEN LINK: consent-decree-rdg].

### 22.46.14 Defender authority to agree to consent judgment

During any time that Defender is entitled to control the settlement of a claim against Beneficiary: Defender is free — in Defender's sole discretion (see the definition in Clause 22.49) — to agree, on Beneficiary's behalf, to a settlement with the claimant that includes entry of a consent judgment that is binding on Beneficiary,

EXCEPT that Defender has no authority to agree on Beneficiary's behalf to a consent judgment if the consent judgment contains any term inconsistent with [NONE].

*Commentary*

In intellectual-property cases, settlements of claims sometimes include the entry of consent judgments; this section gives Defender the power to commit Beneficiary to a consent judgment, but only within specified limits.

(Concerning consent judgments, see the additional reading at [BROKEN LINK: consent-decree-rdg][BROKEN LINK: consent-decree-rdg][BROKEN LINK: consent-decree-rdg].)

### 22.46.15 Beneficiary settlement on its own

IF: Defender is defending the against the claim as provided in this Clause;

AND Beneficiary settles with the claimant without Defender's prior written permission;

THEN: Beneficiary will be deemed to have released Defender from any further defense- or reimbursement obligation as to the claim,

> unless Defender *unreasonably* withheld consent to the Beneficiary's settlement,
>
> in which case Defender's defense- and reimbursement obligations will remain in place.

### 22.46.16 Indemnity terms apply to defense obligations

Defender's obligations under this Clause are to be considered a type of indemnity obligation under Tango Clause 22.78 - Indemnities Protocol,

> meaning (without limitation) that the exclusions and limitations of that provision will apply equally to this Clause.

## Clause 22.47 Deliverable Definition

a. The term "*deliverable*" refers to:

any tangible goods,

and any intangible information, no matter how transmitted or stored,

in either case to be delivered to a party ("*Customer*") under the Contract.

b. For purposes of subdivision a, a deliverable could take the form of Customer's own goods or information,

transformed and/or otherwise processed under the Contract.

*Commentary*

The meaning of *deliverable* was one of many issues litigated in an Eighth Circuit case in which the court affirmed judgment on a jury verdict that Walmart had stolen trade secrets of a software developer.

See Walmart, Inc., v. Cuker Interactive, LLC, 949 F.3d 1101, 1110 (8th Cir. 2020).

## Clause 22.48 Deposits

A party that receives a deposit must:

1. apply the deposit as agreed; and
2. promptly refund any remaining balance — without interest.

*Commentary*

The above language should provide some assurance that the deposit will be "properly" handled.

Background: A supplier or other provider will sometimes ask a customer for a deposit —

- to serve as an available pot of money in case the customer fails to pay or decides to pull the plug before completion;
- to provide working capital for the supplier to use in purchasing necessary materials;
- to give the customer more of a feeling of commitment to the deal.

Drafters might want to consider the following:

1. What if any deposit(s) are required?
2. How much the deposit(s) should be?
3. When must any particular deposit be paid?
4. What, if anything, may the receiving party do with the deposit?
5. Where (and/or by whom) a deposit will be held?
6. Will a deposit bear interest?

## Clause 22.49 Discretion Definition

### 22.49.1 Applicability

This Definition applies any time that the Contract provides that a party, referred to as "*ABC*," may act in its discretion.

### 22.49.2 Sole discretion

1. Whenever the Contract provides that ABC may act in its "sole discretion" (or, equivalently, in ABC's "unfettered discretion" or "absolute discretion" or similar terms), it means that ABC may act as its sees fit —

a. with regard solely to ABC's own interests and desires as ABC then perceives them,

b. and without the need to show any justification; and

2. In any such case, ABC is to be conclusively deemed to have satisfied any applicable standard of good faith or fair dealing.

*Commentary*

If the Contract gives a party *sole*, *absolute*, and/or *unfettered* discretion as to a particular matter, the parties' clear intent is that the party exercising such discretion shouldn't be second-guessed later about its action. Unlike the UK cases cited in the commentary to [NONE], this section's definition does not impose a good-faith requirement on exercises of *sole* discretion, because doing so can complicate litigation.

BUT: This section might not be enforced in some jurisdictions; for example, a New York appeals court refused to honor a "sole and absolute discretion" clause in an agreement, noting that:

> [E]ven where one has an apparently unlimited right under a contract, that right may not be exercised solely for personal gain in such a way as to deprive the other party of the fruits of the contract. Thus, even an explicitly discretionary contract right may not be exercised in bad faith so as to frustrate the other party's right to the benefit under the agreement.

Shatz v. Chertok, 2020 NY Slip Op 1383 (N.Y. App. Div.) (affirming denial of motion to dismiss complaint for breach of fiduciary duty; cleaned up, citation omitted).

### 22.49.3 "Discretion" = *reasonable* discretion

1. Whenever the Contract uses the term *discretion* (without modifier or qualification) or *reasonable discretion*, it means that ABC must act in accordance with commercially-reasonably standards and in good faith.

2. In any such case, ABC is to be strongly presumed to have complied with subdivision a unless shown otherwise by clear and convincing evidence (see the definition in Clause 22.30).

*Commentary*

In some U.S. jurisdictions, a party's discretion might be constrained by an implied obligation of reasonableness, or perhaps of good faith.

See, e.g., Han v. United Continental Holdings, Inc., 762 F.3d 598 (7th Cir. 2014) (applying Illinois law).

And in the UK, there is case law indicating that discretion must be exercised in good faith and not arbitrarily, capriciously, or irrationally.

See generally James Brown, Cathay Pacific Airways Limited v. Lufthansa Technik AG - the extent to which contractual rights be limited by considerations of good faith or a duty to act "ra-

tionally"? (HaynesBoone.com 2020) *discussing* Cathay Pacific Airways Limited v. Lufthansa Technik AG, [2020] EWHC 1789 (Ch); Barry Donnelly and Jonathan Pratt, Are you obliged to act reasonably?, in the In-House Lawyer, June 2013, at 20, https://perma.cc/H9HW-7KDA.

Analogously: In the context of *judicial* discretion, the (U.S.) Supreme Court has noted that:

> Discretion is not whim. In a system of laws discretion is rarely without limits, even when the statute does not specify any limits upon the district courts' discretion. A motion to a court's discretion is a motion, not to its inclination, but to its judgment; and its judgment is to be guided by sound legal principles. Thus, … a district court's discretion should be exercised in light of the considerations underlying the grant of that discretion.

Halo Elecs., Inc. v. Pulse Elecs., Inc., 136 S. Ct. 1923, 1931-32 (2016) (cleaned up, citations omitted).

Subdivision b: The "strong presumption" language borrows from the business-judgment rule that is applied to directors of a corporation, albeit without the other duties that bind directors, most notably the duties of loyalty and care.

See generally, e.g., Lindsay C. Llewellyn, Breaking Down the Business Judgment Clause (Winston.com 2013), https://perma.cc/TR7G-CNU8.

### 22.49.4 Discretionary consent

The term *discretionary consent* refers to consent that may be granted or withheld in the grantor's sole discretion (see [NONE]).

*Commentary*

This is a convenience definition.

### 22.49.5 Not acting = acting

In case of doubt: For purposes of this Definition, not acting is considered an action.

*Commentary*

This is a roadblock clause to forestall creative arguments to the contrary.

## Clause 22.50 Discretionary Consent Definition

See [NONE].

## Clause 22.51 Disparagement Prohibition

a. *Prohibition:* Each Party must refrain from making,

to any third party,

any disparaging statement —

about any other party to the Contract ,

and/or about the products or services of that other party.

b. *Broad scope:* Unless the Contract clearly provides otherwise:

1. all disparaging statements are prohibited, not merely false- or misleading ones; and

2. disparaging statements of fact, as well as of opinion, are prohibited.

c. *Definition: Third party:* For purposes of subdivision a, the term "third party" does not include:

1. the other party's affiliates (see the definition in Clause 22.2), nor

2. the officers, employees, distributors, resellers, and agents of the other party or any of its affiliates.

### Commentary

#### 22.51.1 Business context

Sellers sometimes ask for disparagement prohibitions in their contracts, with the idea that they can prohibit their distributors, resellers, and customers from making negative comments to others.

Examples:

• A buyer of a private company might well ask for a nondisparagement provision in the purchase agreement. This was the case when InfoGroup founder Vinod Gupta sold his company and later was found to have violated a nondisparagement clause in his buyout agreement when he said to a reporter that the company "[has] no leadership, no brains and their product is obsolete."

InfoGroup v. DatabaseLLC, No. 18-3723, slip op. at 7 (8th Cir. Apr. 27, 2020) (affirming denial of judgment as a matter of law after jury verdict against Gupta) (extra paragraphing added).

• Reality-show producers often demand that cast members sign agreements with nondisparagement clauses. In 2020, the producers of The Bachelorette won a $120,000 arbitration award against a designated-villain cast member for making allegedly "negative or disparaging comments"; the award was confirmed in court.

See Andy Denhart, Bachelorette villain ordered to pay producers $120,000, archived at https://perma.cc/5HJ3-6G4G (RealityBlurred.com Oct. 12, 2020).

### 22.51.2 State law might limit enforceability

Some jurisdictions might limit a party's ability to enforce a disparagement prohibition; for example:

• In California, Cal. Civ. Code § 1670.8 prohibits such provisions in consumer contracts, with civil penalties for violation.

• Also in California, Cal. Gov. Code § 12964.5 provides in part: "(a) It is an unlawful employment practice for an employer, in exchange for a raise or bonus, or as a condition of employment or continued employment, to do either of the following: … (2)(A) For an employer to require an employee to sign a nondisparagement agreement or other document that purports to deny the employee the right to disclose information about unlawful acts in the workplace, including, but not limited to, sexual harassment." (An exception is provided for negotiated settlements where the employee is given notice and has an opportunity to be represented by an attorney.)

### 22.51.3 The NLRB doesn't like anti-disparagement clauses

The (U.S.) National Labor Relations Board has taken the position that a lawsuit by an employer to enforce a contractual non-disparagement provision would be partly preempted by the National Labor Relations Act, and that the employer's continued prosecution of the lawsuit after receiving a warning letter from the NLRB would violate the Act.

See Advice Memorandum (Strange Law Firm), March 4, 2019.

### 22.51.4 The FTC might claim a "gag order" clause was illegal

In a Florida case, the Federal Trade Commission obtained summary judgment that a "gag clause" binding customers of the defendants' weight-loss products was an unfair practice in violation of Section 5 of the FTC Act — and later ordered the defendants to pay $25 million to the FTC "as equitable monetary relief, including consumer redress and disgorgement of ill-gotten gains" for false advertising.

See FTC v. Roca Labs, Inc., 345 F. Supp. 3d 1375, 1393-97 (M.D. Fla. 2018) (summary judgment as to liability); No. 8:15-cv-2231-T-35TBM, slip op. at 18 (M.D. Fla. Jan. 4, 2019) (final judgment).

#### 22.51.5 Pro tip: Consider "the Streisand effect"

A disparagement prohibition could lead to bad publicity. Consider the so-called Streisand effect: When the legendary singer-actress tried to suppress unauthorized photos of her residence, the resulting viral Internet publicity resulted in the photos being distributed even more widely — thus defeating her purpose.

#### 22.51.6 Disparagement in the course of litigation

The litigation privilege might trump a contractual non-disparagement provision.

See, e.g., O'Brien & Gere Engineers, Inc. v. City of Salisbury, 135 A.3d 473, 447 Md. 394 (2016).

## Clause 22.52 Dispute Management

In any case where the parties are not able to resolve a dispute themselves at the working level, they are proceed as follows, in the order stated:

1. The parties are to internally escalate the dispute in accordance with [NONE].

2. If escalation does not result in settlement: Either party may present the dispute to senior management in a mini-trial in accordance with [NONE].

3. To promote settlement, Tango Clause 22.19 - Baseball Arbitration is to be used for disputes falling within its scope.

*Commentary*

The idea here is to provide strong incentives for the individuals on both sides to be reasonable.

## Clause 22.53 Effective Date Definition

The effective date of the Contract is the date signed by the last party necessary to make the Contract a legally-binding contract *unless* the Contract clearly states otherwise.

*Commentary*

Unless a contract says otherwise, it will normally go into effect when both (or all) parties have signed it and (if signing separately) each party has delivered its signed counterpart to the other party. This Definition states a "default" provision in that regard.

Author's note: I strongly prefer the last-date-signed approach shown above, as opposed to pre-typing the date of the contract in the preamble — the last-date-signed approach helps to reduce the temptation for parties to backdate a contract for deceptive purposes, **which has landed people in jail.** as discussed in the commentary at [NONE].

(Concerning the contract's preamble itself, see the reading at Section 3.5: .)

Some drafters *pre-type* the date *in the signature block*, but that's not the best idea either — for reasons also discussed in the extended commentary at Section 3.7.2: , the better practice is to include an underscored blank line for the signer to handwrite the date.

## Clause 22.54 Ending Time Definition

IF: The Contract states that a time period, a right, an obligation, etc., is to end or expire on a specified day,

BUT: The Contract does not clearly indicate the *time* of day for ending or expiration;

THEN: The end or expiration will be at exactly 12 midnight at the end of the specified date;

AND: The time zone to be used is the time zone where the relevant actor, or the action to be taken, is located (or, if applicable, is required to be located) at that time,

if not otherwise agreed in writing.

*Commentary*

Another time-zone possibility would be to use Coordinated Universal Time, which is basically Greenwich Mean Time with a few technical differences; see generally the Wikipedia article Universal Time.

Time zones are also addressed in Tango Clause 22.42 - Day Definition.

## Clause 22.55 Entire Agreement

### 22.55.1 Complete, final, exclusive agreement

The Contract is the parties' complete, final, and exclusive agreement concerning the matters addressed in it *unless* the Contract clearly says otherwise.

*Commentary*

If a dispute arises concerning a contract, a party might claim that the signed contract wasn't "the whole deal" and that other terms and conditions — in side letters or even alleged oral agreements — must supposedly be taken into account as well. Such claims can seriously muddy the water and lead to extra delay and expense.

In the above language, the "complete, final, and exclusive" phrasing draws on the entire-agreement language of section 2-202 of the Uniform Commercial Code (which deals with sales of goods).

### 22.55.2 Merger of prior discussions

All prior discussions between the parties concerning the matters addressed in the Contract — oral, written, or otherwise, of any kind, in

any medium, including but not limited to representations — are to be treated as having been merged into and replaced by the Contract.

*Commentary*

In the above language, the term "merged" is a "term of art" that will be readily understood by lawyers and judges.

### 22.55.3 Subsequent purchase orders, invoices, etc.

Additional- or different terms, in a purchase order, order confirmation, invoice, or similar document ("*Other Document*"), will be of no effect — even if one or more parties takes action consistent with those terms — *unless* that Other Document:

1. expressly, specifically, and prominently identifies the Contract;
2. specifically and unambiguously states that the Other Document takes precedence over *the Contract* — a generic precedence provision is not sufficient for this purpose; and
3. is signed by the party sought to be bound by the additional or different terms.

*Commentary*

Even when parties have agreed in writing about the terms on which they do business, their procurement- or sales people might reflexively issue purchase orders, sales confirmations, and similar documents.

- Such party-issued documents typically include terms and conditions that might be significantly different than what the parties agreed to (read: heavily biased in favor of the issuing party).
- Allowing such additional– or different terms to take precedence could tempt a party to try to "re-trade the deal" by including such other terms in a purchase order, an order confirmation, an invoice, etc.

So this section lays out ground rules for dealing with such additional- or different terms.

See also the "Battle of the Forms" discussion at Section 2.9: .

### 22.55.4 Governing law for this Clause

In the interest of uniformity, the parties desire that this Clause be interpreted and applied in accordance with section 2-202 of the Uniform Commercial Code as enacted in New York and the interpretations of that statute by courts having jurisdiction in that state, even article 2 of the UCC would not otherwise apply.

*Commentary*

It's possible, and sometimes useful, to specify a particular governing law for a particular clause of a contract, for reasons discussed in the commentary at Section 22.70.14: .

UCC article 2 applies by its terms to sales of goods, but the author is unaware of any *a priori* reason that parties can't agree to have that statutory provision apply to non-sales contracts as well.

The term "courts *having jurisdiction in* that state" is phrased in that way to allow for federal- as well as state-court interpretations.

Cf. Doe 1 v. AOL, LLC, 552 F.3d 1077, 1081-82 (9th Cir. 2009) (per curiam), where a forum-selection provision that referred to the courts *of* a specified state included only *state* courts, not federal.

See also Tango Clause 22.70 - Governing Law and its commentary.

## Clause 22.56 Equitable Relief

a. Any party, referred to here as a "*claimant*," upon proper proof, may seek injunctive relief against actual- or imminent breach of the Contract in accordance with the four-factor test restated by the (U.S.) Supreme Court in eBay Inc. v. MercExchange, L.L.C., 547 U.S. 388, 391 (2006).

b. Each other party, referred to here as a "*respondent*," acknowledges (see the definition in Clause 22.1) that some types of breach of the Contract by the respondent could result in irreparable harm to the claimant, that would not be adequately compensable by monetary damages or other remedies at law.

Commentary

### 22.56.1 Caution: This would be a major concession

Reviewers being asked to agree to language like this should pay careful attention to it, because it could end up significantly disadvantaging the party against which injunctive relief is someday sought, for the reasons discussed below. A potential future "Respondent" might not want to stipulate to irreparable harm, because doing so would absolve the Claimant from what might be a significant burden of proof, as discussed below.

On the other hand, in some cases — e.g., misappropriation of crucial trade secrets — the existence of irreparable harm might be pretty obvious. In such a case, it might not be much of a concession for a potential Respondent to stipulate in advance to the existence of irreparable harm.

### 22.56.2 Legal background: The four-factor proof requirement for injunctive relief

In U.S. jurisdictions, a party seeking an injunction or similar equitable relief must **show**, not merely allege, that (among other things) it has suffered or is likely to suffer irreparable harm that could not be adequately compensated by remedies available at law, such as monetary damages.

As explained by the Supreme Court of the United States:

> According to well-established principles of equity, a plaintiff seeking a permanent injunction must satisfy a four-factor test before a court may grant such relief.
>
> A plaintiff must **demonstrate:**
>
> (1) that it has suffered an irreparable injury;
>
> (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury;
>
> (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and
>
> (4) that the public interest would not be disserved by a permanent injunction.
>
> The decision to grant or deny permanent injunctive relief is an act of equitable discretion by the district court, reviewable on appeal for abuse of discretion.

eBay Inc. v. MercExchange, L.L.C., 547 U.S. 388, 391 (2006) (describing traditional four-factor test in context of patent-infringement injunctions) (citations omitted, emphasis and extra paragraphing added).

### 22.56.3 Language choice: A compromise

Claimants sometimes press for a stronger version of this Clause, asking the respondent to stipulate that the breach *would* result in irreparable harm to the claimant. That might well be a major concession by the respondent, absolving the claimant from what could be a significant burden of proof in litigation, as discussed below.

Of course, in some cases — for example, cases involving misappropriation of crucial trade secrets — the existence of irreparable harm might be obvious. In such a case, it might not be much of a concession for a potential respondent to stipulate in advance to the existence of irreparable harm.

See also the commentary to Tango Clause 22.24 - Bond Waiver, which likewise can be dangerous to a party that might have to defend against a motion for preliminary injunction or similar equitable relief.

### 22.56.4 Stipulations to irreparable harm have been enforced

In a 2012 opinion, then-chancellor Strine of the Delaware chancery court (now chief justice of the state's supreme court) relied in part on a similar clause in granting a four-month injunction against one company's hostile takeover bid targeting another company:

> In Delaware, parties can agree contractually on the existence of requisite elements of a compulsory remedy, such as the existence of irreparable harm in the event of a party's breach, and, in keeping with the contractarian nature of Delaware corporate law, this court has held that such a stipulation is typically sufficient to demonstrate irreparable harm.

Martin Marietta Materials, Inc v. Vulcan Materials Co., 56 A.3d 1072, 1144-45 (Del. Ch.), *aff'd*, 45 A.3d 148 (Del. 2012) (en banc) (footnotes with extensive citations omitted).

### 22.56.5 But a contract can't *force* a court to issue an injunction

Even if a contract stipulates that a party will suffer irreparable harm from breach, a court might not give effect to the stipulation. "We hold that the terms of a contract alone cannot require a court to grant equitable relief. In doing so, we adopt the accepted rule of our sister circuits that have addressed the question."

Barranco v. 3D Sys. Corp., 952 F.3d 1122, 1130 (9th Cir. 2020) (reversing grant of disgorgement remedy) (citing cases).

And the Delaware chancery court disregarded a contractual stipulation of irreparable harm in one case:

> Parties sometimes … agree that contractual failures are to be deemed to impose the risk of irreparable harm. Such an understanding can be helpful when the question of irreparable harm is a close one.
>
> Parties, however, cannot in advance agree to assure themselves (and thereby impair the Court's exercise of its well-established discretionary role in the context of assessing the reasonableness of interim injunctive relief) the benefit of expedited judicial review through the use of a simple contractual stipulation that a breach of that contract would constitute irreparable harm.
>
> *[In footnote 20 the court added:]* In part, this is simply a matter that allocation of scarce judicial resources is a judicial function, not a demand option for litigants.

AM General Holdings LLC v. The Renco Group, Inc., No. 7639-VCN, slip op. at 10, text accompanying nn.19-20 (Del. Ch. Dec. 29, 2015) (denying request for preliminary injunction) (footnotes omitted, extra paragraphing added).

For a useful catalog of things that might qualify as irreparable harm, see the cases cited in Paige Bartholomew, Commercial Division Judge Reaffirms "Most Critical" Element for Injunctive Relief: Irreparable Harm (JDSupra 2020) (scroll down to the list of bullet points).

## Clause 22.57 Escalation of Disputes

a. *Escalation upon request:* Promptly upon request by either party, the parties must escalate a dispute by (in succession) a total of up to two levels.

b. *Prerequisite to litigation:* The parties must finish such escalation (both levels if requested) before initiating litigation or arbitration, EXCEPT:

1. to the minimum extent necessary:

   to prevent irreparable harm, and/or

   to meet a deadline for taking action under an applicable statute of limitations or statute of repose —

   in which case each party must offer to escalate immediately after commencing litigation or arbitration; or

2. if the other party refuses to cooperate in escalation.

### 22.57.1 Commentary

### 22.57.2 Subdivision a: Why escalate disputes?

Disputes can often be nipped in the bud if the parties would just talk to each other regularly, as provided in Tango Clause 22.147 - Status Conferences. But in case that *doesn't* happen, escalation can help parties to resolve disputes before the parties dig their heels in — *and a party would be in breach of contract if it refused to escalate* when asked.

Escalation can be effective in resolving disputes at the working level because, as one article puts it, "the threat to line managers of having to explain to senior executives of both companies the failure to effectively cooperate likely carried more weight than the threat of legal action." The authors continue: "Superiors are unlikely to look with favor on subordinates who send problems up the line for resolution. The subordinates' job is to resolve problems, not escalate them."

> Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration, 109 Colum. L. Rev. 431, 470, 481 (2009), archived at https://perma.cc/TYY2-423D.

For another example of escalation-clause language, see the CPR International Model Multi-Step Dispute Resolution Clause (scroll down to "(A) Negotiation").

### 22.57.3 Mechanics of escalation

If a party asks for escalation, each party should advise the other party in writing of the name and contact information of a representative at the next-up management level (each, a "*senior representative*").

Each senior representative should have authority to discuss — and, preferably, the authority to settle — the dispute on behalf of the party represented.

Senior representatives should meet at least once by video conference (or by phone or in person if they agree) and try to settle the dispute.

Arrangements for senior representatives' meetings would typically be initiated and coordinated by the party making the request for escalation.

It can be helpful for each party to provide the other party, in advance of each senior representative meeting, with a reasonably-detailed written statement of the providing party's then-current position in the dispute.

#### 22.57.4 Subdivision b: How far up to escalate?

Some escalation provisions require issues to be referred all the way up to "executive-level management." Apart from the vagueness of that term, a giant multinational corporation isn't likely to want to be forced to escalate a small-dollar issue all the way to its executive suite.

#### 22.57.5 Prerequisite to litigation

With limited exceptions, this Clause requires escalation to be completed before litigation or arbitration is initiated — this requirement seeks to forestall a non-aggrieved party from racing to the courthouse (or to arbitration) to get a home-court advantage.

## Clause 22.58 Evergreen Extensions

### 22.58.1 Applicability; definitions

This Clause will apply if the Contract, in substance:

1. sets forth a time period; a right; or an obligation — each referred to generically here as an "*Evergreen Period*" — that by its terms is to expire at a particular time; and

2. clearly indicates that the Evergreen Period is to be automatically renewed or extended for one or more specified periods.

*Commentary*

*22.58.1.1 Language choice: Extension vice renewal*

This Clause uses the term "extension" because the word "renewal" (which seems to be the common term) *might* require a party to renegotiate as a condition of being able to exercise an option to renew.

See Camelot LLC v. AMC ShowPlace Theatres, Inc., 665 F.3d 1008, 1011-12 (2012) (8th Cir. 2012), where a movie theater chain's option to "extend" its lease of space in a shopping center required landlord agreement to new terms. (See also my blog post criticizing the decision.) *But see* Indian Harbor Ins. Co. v. F&M Equip., Ltd., 804 F.3d 310 (3d Cir. 2015): Citing Black's Law Dictionary, the court held that a "renewal" of an insurance policy "requires continuation of coverage on the same, or nearly the same, terms as the policy being renewed." *Id.* at 315 (cleaned up, footnote omitted).

#### *22.58.1.2 Caution: State-law restrictions*

By law, some states restrict automatic extension or renewal of certain contracts (often consumer-facing) unless specific notice requirements are met. For example, beginning in 2021, a New York statute requires clear and conspicuous disclosure of automatic renewal terms in consumer service contracts.

See NY Gen. Bus. L. art. 29-BB, *discussed in* David O. Klein, New York To Implement New Auto-Renewal Law (Mondaq.com 2020). See generally Laura Koewler Marion, Automatic Renewal Laws in All 50 States … (March 2019 version archived at https://perma.cc/Q8FR-RUFC).

On the other side of the coin, however: A Minnesota statute, which regulates termination of sales-representation agreements, states that a sales-rep agreement without a definite term *is* automatically "renewed" if, "with the principal's consent *or acquiescence*, the sales representative solicits orders on or after the effective date of" the amendatory law.

See Minn. Stat. § 325E.37 § 2(a)(2), *discussed in* Engineered Sales Co. v. Endress + Hauser, Inc., No. 19-1671, slip op. at 5 (8th Cir. Nov. 17, 2020) (reversing and remanding summary judgment).

### 22.58.2 Opting out of an extension; deadline

a. Any party may opt out of an automatic extension of the Evergreen Period, in that party's sole discretion (see the definition in Clause 22.49),

> by giving notice (see the definition in Clause 22.112) to that effect;
>
> the opt-out notice must be effective no later than 30 days before — or, if so stated in the Contract, after — the expiration of the Evergreen Period.

b. If an eligible party does opt out, then the Evergreen Period will automatically come to an end at its then-current expiration date.

c. If no (eligible) party opts out of automatic extension as provided above, then the Evergreen Period will be extended,

at its then-current expiration date, and on the same terms,

for successive extension periods, without a break,

except as otherwise stated in this Clause.

*Commentary*

In subdivision a, the "sole discretion" language is intended to forestall any claim that a decision to opt out is subject to any kind of duty of good faith and/or fair dealing. In its *Bhasin* opinion, the Supreme Court of Canada surveyed U.S. cases on this point.

See Bhasin v. Hrynew, 2014 SCC 71 [2014] 3 S.C.R. 495, ¶ 91.

**Caution:** In a Canadian case, the agreement in suit involved the software giant Oracle Corporation and a member of Oracle's partner network. The agreement gave Oracle the sole discretion to accept the partner's application to renew the agreement; for 20 years the agreement was renewed each year. But in 2014, Oracle invited the partner to renew the agreement, but then rejected the partner's renewal application. The partner filed suit; the trial court denied Oracle's motion to dismiss, holding that a dictum in *Bhasin* "does not stand for the (extreme) proposition that under no circumstances does a 'sole discretion' contract renewal power have to be exercised reasonably."

Data & Scientific Inc. v. Oracle Corp., 2015 ONSC 4178 (CanLII).

### 22.58.3 No maximum number of automatic extensions

The Evergreen Period will continue to be extended indefinitely, with no maximum number of extensions, until such time (if any) as an eligible party opts out,

unless the Contract clearly specifies otherwise.

### 22.58.4 Maximum duration of an automatic extension

Each successive evergreen-extension period will be (i) the same duration as the original duration of the Evergreen Period, or (ii) one year, whichever is less, unless clearly agreed otherwise in writing, by both parties, for a specific extension.

*Commentary*

#### *22.58.4.1 Illustrative examples*

This section puts an upper limit on the duration of an *automatic* extension (the parties are of course free to affirmatively agree to any extension they want).

- Example 1: A six-month Evergreen Period would be automatically extended for successive six-month terms.
- Example 2: A three-year Evergreen Period would be automatically extended for successive one-year terms.

#### *22.58.4.2 Danger of too-long an extension period*

Too-long an automatic-extension period can be problematic. Here's an example that the author once saw with a client: The client, a software provider once gave a steep pricing discount to a particular high-profile customer; the provider agreed that the steep discount would last for five years. (The author was not involved in that transaction.) The agreement provided that the discount would be automatically extended for another five years if the software provider didn't opt out when the first five-year period was expiring. *No one in the software provider's organization noticed that the five-year discount period was ending*.

As a result, the software provider didn't remember send the customer a notice that the client was opting out of the pricing commitment — and so the provider had to honor the steeply-discounted pricing for that customer *for another five years* — even though the provider had raised its prices significantly for the rest of its customer base.

#### *22.58.4.3 Pro tip: Longer durations for subsequent extension periods?*

Evergreen extension periods could be of different lengths; for example, in some contractual relationships: A first extension period might be relatively short, to give the parties a chance to find out what it's like working together; then, if neither party opts out, subsequent extension periods could be of longer duration.

### 22.58.5 Option: Mandatory Reminder of Upcoming Expiration

a. *Applicability:* This Option applies applies if the Contract:

allows one party, referred to generically here as "*Customer*," to opt out of automatic extension of the Evergreen Period; and

does not allow the other party, referred to generically here as "*Provider*," to opt out of automatic extension.

Note: These placeholder names are used here because automatic extensions are often seen in provider-customer agreements; this Option is

not limited to such agreements.

b. *Expiration-reminder requirement:* For the Evergreen Period to be automatically extended, Provider must send Customer a written reminder of the upcoming expiration date of the Evergreen Period.

c. *Time window for expiration reminder:* For the expiration reminder to be effective, Customer must receive or refuse the reminder, or the reminder must be undeliverable after reasonable efforts,

no earlier than 60 days, and no later than 30 days, before the upcoming expiration date.

d. *If no reminder:* If Provider does not timely send Customer the expiration reminder, then Customer may affirmatively elect to extend the Evergreen Period,

for the same length of time as would otherwise have happened automatically,

by giving Provider notice of its election to extend;

e. BUT: For Customer's election to extend to be effective, the notice of election must be effective on or before:

30 days after Customer receives a belated reminder from XYZ, if any,

or if earlier, 90 days after what would otherwise have been the expiration date of the Evergreen Period.

f. *No reminder if both parties can opt out:* In case of doubt: If the Contract allows each party to opt out of automatic extension, then no reminder is necessary.

*Commentary*

This mandatory-reminder option is intended to prevent a party that doesn't *want* to extend an Evergreen Period (e.g., a provider) from allowing the Evergreen Period to expire silently without first reminding the party eligible extension (e.g., a customer) that the opt-out deadline is coming up.

### 22.58.6 Option: Extension Opt-Out Fee

a. If a party opts out of an extension under Tango Clause 22.58 - Evergreen Extensions before [specify date],

then that party must pay the other party an early opt-out fee of [FILL IN AMOUNT, no later than 12 midnight UTC at the end of the day on the then-current expiration date of the Extendable Period;

otherwise, the extension will go into effect, and the right to opt out of the extension will expire, with no further action by any party.

b. In case of doubt, the early opt-out fee of this section is intended as a form of alternative performance and not as liquidated damages.

*Commentary*

This provision was inspired by an analogous provision in a Ninth Circuit case where the court of appeals affirmed a summary judgment that a Canadian food distributor owed a U.S. marketing firm a fee for electing not to renew the parties' "evergreen" agreement.

See Foodmark, Inc. v. Alasko Foods, Inc., 768 F.3d 42 (1st Cir. 2014).

The intent of the early opt-out fee is to give the other party a specified minimum time in which, say, to recoup the investments it makes in supporting the parties' contractual relationship.

### 22.58.7 Option: No Evergreen Extension After Assignment

a. If this Option is agreed to, automatic extension under this Option will not occur at any time after assignment of the Contract by either party.

b. In case of doubt: This Option neither authorizes nor restricts assignment of the Contract.

*Commentary*

This Option is inspired by § 4.3 of the 2007 real-estate lease between Stanford University (landlord) and Tesla (tenant).

See also Tango Clause 22.10 - Assignment - Assignee Assumption and Tango Clause 22.11 - Assignment Consent.

## Clause 22.59 Examples Definition

a. Examples are for purposes of illustration and not limitation.

b. When examples of a term are given, the parties do not intend for the principle of ejusdem generis ("of the same kind") to limit the term's meaning unless clearly stated otherwise.

c. The Contract might sometimes use longer expressions such as "by way of example and not of limitation";

> such expressions do not mean that the parties intend for *shorter* expressions such as "for example" to function as limitations unless expressly stated otherwise.

*Commentary*

Including this definition in a contract will let drafters safely say, e.g., "including, for example," which is somewhat less stilted than "including, by way of example and not of limitation."

*Ejusdem generis*: As the Third Circuit pointed out: "By using the phrase 'including, but not limited to,' the parties unambiguously stated that the list was not exhaustive. … [S]ince the phrase 'including, but not limited to' plainly expresses a contrary intent, the doctrine of *ejusdem generis* is inapplicable."

> Cooper Distributing Co. v. Amana Refrigeration, Inc., 63 F.3d 262, 280 (3d Cir. 1995) (Alito, J.) (citations omitted). To like effect is Eastern Air Lines, Inc. v. McDonnell Douglas Corp., 532 F.2d 957, 988-89 (5th Cir. 1976); see also Robert E. Scott and George G. Triantis, Anticipating Litigation in Contract Design, 115 Yale L.J. 814 (2006): "Contracting parties can avoid a restrictive interpretation under the *ejusdem generis* rule by providing that the general language includes but is not limited to the precise enumerated items that either precede or follow it." *Id.* at 850 & n.100, *citing Cooper Distributing and Eastern Airlines*.

## Clause 22.60 Exclusivity

a. *Applicability:* This Clause will govern when, under the Contract, one party, referred to as "*Grantor*," grants (explicitly or implicitly) to another party, referred to as "*Recipient*," the right to engage in one or more activities, referred to for this purpose as "*Activities*";

this grant is referred to as the "*Grant*."

b. *Default mode is no exclusivity:* The Grant is not exclusive unless the Grant explicitly says so in writing. This means, without limitation, that:

1. Grantor is free — in its sole discretion (see the definition in Clause 22.49) — to enter into similar- or identical arrangements with others;

this is true even if one or more of those others are competitors of Recipient; and

2. in case of doubt, Recipient is likewise free, in *its* sole discretion, to enter into similar arrangements with others.

c. *Grantor freedom of action:* Even if the Grant *is* exclusive, that exclusivity does not preclude Grantor from engaging the same Activities,

anywhere in the world in any market segment,

even if Grantor would be competing with Recipient,

unless the Grant expressly states otherwise.

d. *No accounting required:* If the Grant is exclusive, then Grantor need not (i) account to Recipient, nor (ii) compensate Recipient, if Grantor engages in one or more of the Activities.

Commentary

### 22.60.1 Subdivision d: No accounting required

U.S. copyright law requires that co-owners of a copyright in a work of authorship, unless they agree otherwise, must "account" to one another for their uses of the work — basically, this means sharing profits / royalties.

See the commentary to [NONE].

### 22.60.2 Amazon learns that breach of exclusivity can have consequences

Violating an exclusivity clause can lead to serious consequences. For example: Online giant Amazon and the owner of a commercial building in New York City on the Avenue of the Americas (the "Avenue building") entered into a nonbinding letter of intent ("LOI").

- Under the LOI, the parties were to negotiate for Amazon to lease ten floors in the Avenue building.

- Importantly, the LOI included an exclusivity clause prohibiting Amazon from negotiating with any other landlord during a stated period.
- But while the parties were negotiating the formal lease for the Avenue building, Amazon secretly shopped for other space without telling the Avenue building owner — while insisting that the owner proceed with renovations that would need to be completed before Amazon moved in.
- Amazon eventually jilted the Avenue building owner, signing a lease for space in another Manhattan building. This left the Avenue building owner stuck with the extensive costs of the renovations it had done at Amazon's insistence.

The jilted Avenue building owner sued Amazon for breach of the exclusivity provision of the LOI (and also for fraud); the trial court granted the building owner's motion for summary judgment of breach. *See* DOLF 1133 Properties II LLC v. Amazon Corporate, LLC, 2020 N.Y. Slip Op. 30274(U), No. 653789/2014 (N.Y. Sup. Ct. Jan. 6, 2020) (partly granting Avenue building owner's motion for summary judgment); see also DOLF 1133 Properties II LLC v. Amazon Corporate, LLC, No. 653789/2014, slip op. at 8 (N.Y. Sup. Ct. Aug. 17, 2015) (denying most of Amazon's motion to dismiss).

(It surely did not help Amazon's image in the case that not even a year before, the company had backed out on its selection of the borough of Queens as the location of its planned second headquarters, following intense community backlash after the selection was announced. See, e.g., J. David Goodman, Amazon Pulls Out of Planned New York City Headquarters, N.Y. Times, Feb. 14, 2019.)

## Clause 22.61 Expense Reimbursement

### 22.61.1 No reimbursement unless agreed

No party need reimburse any other party's expenses related to the Contract unless clearly agreed otherwise in writing.

*Commentary*

The above language is an "avoidance of doubt" or "level set" ground rule.

**Checklist:** Drafters of expense-reimbursement provisions might want to consider the following issues:

1. What types of expenses will be eligible for reimbursement?

2. May the incurring party seek an advance on reimbursement, i.e., *before* it pays a reimbursable expense?

3. Must the incurring party comply with any particular written reimbursement policy? (Some payers impose detailed requirements for reimbursement, e.g., no first-class travel, no reimbursement for alcoholic beverages, receipts for all expenses over $X, etc.)

4. May an incurring party mark up its expenses? Some contracts are "cost-plus," meaning expenses will normally be marked up.

5. Is preapproval required for any particular expenses?

6. Should some expenses be direct-billed to the payer? *Example:* Suppose that a consultant will be traveling on business for a client and will be billing her expenses to the client. In that situation:

- The consultant might prefer to have her air fare and hotel expenses billed directly to the client, so that she does not have to lay out her own cash for the airline tickets nor front the money to pay her hotel bills.
- The *client* might want the consultant to fly with airlines, and stay at hotels, with which the client has pre-negotiated discount rates.
- An individual person at the client might want to put the expenses on his- or her credit card to get the reward points. (Years ago, the author heard stories about an in-house counsel who, in the course of a major, years-long lawsuit, racked up millions of credit-card reward points by requiring all outside lawyers and paralegals to bill their travel- and lodging expenses to the in-house counsel's credit card, which his employer reimbursed in due course.)

### 22.61.2 Only eligible expenses reimbursed

a. A reimbursing party need not reimburse expenses that:

1. are not of a type that the Contract clearly states is eligible for reimbursement;

2. are not reasonable in amount; and/or

3. were not "actually incurred" by the party seeking reimbursement.

b. For purposes of subdivision a.3, "actually incurring" an expense includes, without limitation, making a legally-binding, non-cancellable commitment to pay for the expense on a non-refundable basis.

*Commentary*

Merely saying (as in subdivision a) that the reimbursing party *need not pay* ineligible reimbursement claims, without more, could be undesirable — it could tempt a fraudster to roll the dice and knowingly submit ineligible or unreasonable expenses, in the hope that the reimbursing party's accounts-payable people might unwittingly pay the improper charges. The following section ([NONE]) specifically prohibits such conduct.

### 22.61.3 Material breach possibility

Knowingly seeking reimbursement of ineligible expenses would be a material breach of the Contract.

*Commentary*

An honest counterparty would never *knowingly seeking* reimbursement of an ineligible expense — but expense-reimbursement fraud is certainly not unheard of. See generally, e.g., Tiffany Couch, Skimming and scamming: Detecting and preventing expense reimbursement fraud (AccountingToday.com 2018).

Courts will generally defer to a contract's explicit statement that a particular type of breach would be "material" (and thus would carry specific consequences), as discussed in the commentary at Section 22.102: (which also explains why it matters whether a particular breach is deemed "material").

### 22.61.4 Original receipts required

A party seeking reimbursement for an expense must provide the paying party with the original receipt for the expense.

*Commentary*

A standard safeguard against fraudulent reimbursement requests is to require receipts — *original* receipts, not copies, to prevent multiple people from submitting the same expense. See, e.g., Abigail Grenfell, Employee expense reimbursements: Legitimate or fraudulent? (MNCPA.org 2015).

To be sure, for "small" expenses, a particular paying party might not want to bother with receipts (original or otherwise) — but keep in mind that fraudsters have been known to intentionally break up expense-reimbursement requests into multiple requests; see the Grenfell article cited above.

### 22.61.5 Expense markup restricted

A party submitting an expense for reimbursement must not mark it up unless the Contract clearly so states.

*Commentary*

Some contracts are intentionally structured as "cost-plus," in which case expenses would be marked up by an agreed amount or percentage. It's important to be clear if this is to be the case.

(Incidentally, contractors generally are indeed quite clear about it when they are to be paid on a cost-plus basis.)

### 22.61.6 Compliance with written expense policy

IF: A payer provides a written expense-reimbursement policy to a party incurring reimbursable expenses — a reasonable time in advance, for example, before the incurring party incurs an expense that cannot be canceled or refunded —

THEN:The incurring party must not knowingly seek reimbursement for expenses that do not conform to the written expense policy;

AND: The payer need not reimburse any such expense.

*Commentary*

The above language has in mind that a customer will sometimes desire (read: demand) that a supplier comply with the customer's expense-reimbursement policies. This is likely to be an administrative pain for a supplier, especially if the supplier has many customers and must manage compliance with many different expense policies. But it's often a practical necessity, especially for large corporate customers that by law must comply with internal-controls requirements.

Note that this language *doesn't* impose a particular expense policy (but instead allows a paying party to do so later). That's because at the time of contracting, a customer (let's say) might or might not care about imposing a specific written-reimbursement policy, but it might want to preserve its option to do so in the future without having to renegotiate the Contract.

### 22.61.7 Preclearance of certain expenses encouraged

A party seeking reimbursement is strongly encouraged — but is not required — to check with the reimbursing party before incurring expenses that might not be eligible for reimbursement under the Contract.

*Commentary*

The above language provides a reminder of a "best practice": Preclearance of "borderline" expenses can help to avoid later disputes.

This language doesn't go as far as a clause that the author once reviewed, which *required* a supplier seeking reimbursement to "flag" any arguably-borderline expenses:

- Presumably this flagging requirement was to help avoid unpleasant surprises when the supplier submitted its reimbursement requests.
- But a party *incurring* expenses probably wouldn't want to agree to a *mandatory* expense-flagging requirement, because a stingy reimbursing party could use a supposed failure to flag as an excuse to withhold reimbursement.

## Clause 22.62 Force Majeure

### 22.62.1 Invocation of force majeure

a. *When permitted:* In response to the *actual*- or *imminent* occurrence of one or more force-majeure events,

either party may invoke force majeure,

by advising another affected party by any reasonable means.

b. *Excused nonperformance:* A party that invokes force majeure as permitted by the Contract,

at a reasonable time — which might be before or after the relevant force majeure event or -events —

will not be liable under the Contract for any loss, injury, delay, damages, or other harm, suffered or incurred by another affected party,

due to failure of timely performance, by the invoking party, resulting from the force majeure,

except as otherwise agreed in writing.

*Commentary*

Subdivision a: A party might need to invoke force majeure *before* the force majeure actually occurs — for example, if a hurricane were approaching or a pandemic were erupting — as well as after the fact.

Subdivision b: See the exception in [NONE] (payment failure limitation).

**Note:** Keep in mind that a force-majeure excuse from performance might very well be available *by law*. See generally Pillsbury Winthrop Shaw Pitman LLP, Tour de Force: Force Majeure in Civil Law Jurisdictions – A Superior Force Majeure Doctrine? (JDSupra.com 2020).

### 22.62.2 Termination after force majeure

Either party may terminate all parties' going-forward obligations under the Contract IF the aggregate effect of the relevant force majeure:

1. is material in view of the Contract as a whole ; and
2. lasts longer than 60 days after that force majeure was duly invoked.

*Commentary*

This termination right is limited to force-majeure events that are material *in view of the Contract as a whole*; this restriction is adapted from a master services agreement, between IBM and the State of Indiana, that was the subject of extended litigation. See Indiana v. IBM Corp., 51 N.E.3d 150, 153 (Ind. 2016), *after remand*, 138 N.E.3d 255 (Ind. 2019).

### 22.62.3 Limited force-majeure excuse for nonpayment

Force majeure will not excuse failure to pay an amount due under the Contract

unless the failure is due to generalized failure,

beyond the invoking party's control,

in all reasonably-available payment systems,

such as, for example (see the definition in Clause 22.59) —

1. banks are closed by government edict; or

2. all of the invoking party's assets that could be used for payment are trapped or stranded in a failed bank or other deposit system.

*Commentary*

This section says, in effect, that an invoking party can't escape a payment obligation unless, for example, the banks are closed, as happened in 1933 during the Great Depression.

That, though, is an issue that parties might want to think about — especially in situations like the COVID-19 pandemic of 2020, in which countless businesses experienced crippling cash-flow problems as a result of government stay-at-home orders. See generally the comments to Ken Adams's blog posting, Excluding from a "Force Majeure" Provision Inability to Comply with a Payment Obligation (2012).

### 22.62.4 Status reports by invoking party

a. IF: Another affected party so requests;

AND The Contract so provides;

THEN: A party invoking force majeure must provide reasonable information to other parties to the Contract,

from time to time as reasonably determined by the invoking party,

about the invoking party's efforts, if any, to remedy and/or mitigate the effect of the force majeure.

b. Any party *receiving* force-majeure status information from an invoking party must treat that information as the invoking party's Confidential Information under Tango Clause 22.34 - Confidential Information,

including but not limited to the exclusions from confidentiality in [NONE].

### 22.62.5 Types of event that can qualify as force majeure

a. The term "*force majeure*" refers generally to any single event or series of events as to which:

a prudent person in the position of the party invoking force majeure,

did not actually anticipate,

could not reasonably have been able to foresee,

and could not have been able to take reasonable measures to avoid,

a failure of timely performance resulting (directly or indirectly) from the event or series of events.

b. The Contract may optionally adopt a "laundry list" of specific types of event that would qualify as force majeure.

*Commentary*

*22.62.5.1 Include a laundry list?*

In New York and possibly in some other jurisdictions, it might be necessary to include a "laundry list" of specific types of event that the parties intend to qualify as force majeure. The *Kel Kim* opinion by the Court of Appeals (the state's highest court) held:

> … Ordinarily, *only if the force majeure clause specifically includes the event that actually prevents a party's performance will that party be excused*. Here, of course, the contractual provision does not specifically include plaintiff's inability to procure and maintain insurance.
>
> Nor does this inability fall within the catchall "or other *similar* causes beyond the control of such party." The principle of interpretation applicable to such clauses *[i.e., ejusdem generis]* is that the general words are not to be given expansive meaning; they are confined to things of the same kind or nature as the particular matters mentioned.

Kel Kim Corp. v. Central Markets, Inc., 70 N.Y.2d 900, 902-03 (1987) (extra paragraphing added, citations omitted); see also the discussion of the contract-interpretation doctrine of *ejusdem generis* in the commentary to Tango Clause 22.59 - Examples Definition.

Some drafters might want to specify that the term *force majeure* includes, without limitation, any event that (i) is not excluded by the Contract and (ii) falls within one or more of the following categories; some of these categories are typographically flagged to indicate that a party might want to exclude them.

• act of a public enemy; • act of any government or regulatory body, whether civil or military, domestic or foreign, not resulting from violation of law by the invoking party; • act of war, whether declared or undeclared, including for example civil war; • act or omission of the other party, other than a material breach (see the definition in Clause 22.102.2) of the Contract; • act or threat of terrorism; • blockade; • boycott; • civil disturbance; • court order; • drought; • earthquake; • economic condition changes generally; • electrical-power outage; • embargo imposed by a government authority; • epidemic or pandemic; • explosion; • fire; • flood;

• hurricane; • insurrection; • internet outage; • invasion; • labor dispute, including for example strikes, lockouts, work slowdowns, and similar labor unrest or strife; • law change, including any change in constitution, statute, regulation, or binding interpretation; • legal impediment such as an inability to obtain or retain a necessary authorization, license, or permit from a government authority; • nationalization; • payment failure *resulting from failure of or interruption in one or more third-party payment systems*; • public health emergency; • quarantine; • riot; • sabotage; • solar flare; • storm; • supplier default; • telecommunications service failure; • tariff imposition; • transportation service unavailability; • tornado; • weather in general.

(The above "laundry list" of examples is drawn from various agreement specimens; it does **not** include the so-called "act of God" because of the vagueness of that term.)

#### *22.62.5.2 CAUTION: Will economic- and market changes count?*

As to market fluctuations, a Texas court of appeals held that :

> … Because fluctuations in the oil and gas market are foreseeable as a matter of law, it *[sic]* cannot be considered a force majeure event *unless specifically listed as such in the contract*.
>
> To dispense with the unforeseeability requirement in the context of a general "catch-all" provision would, in our opinion, render the clause meaningless because *any* event outside the control of the non-performing party could excuse performance, even if it were an event that the parties were aware of and took into consideration in drafting the contract.

TEC Olmos, LLC v. ConocoPhillips Co., 555 S.W.3d 176, 184 (Tex. App.—Houston [1st Dist.] 2018) (emphasis added). As to economic changes generally: See Kevin Jacobs and Benjamin Sweet, 'Force Majeure' In the Wake of the Financial Crisis, Corp. Counsel, Jan. 16, 2014.

### 22.62.6 Option: Supplier allocation

If the Contract requires an invoking party to supply goods or services,

and the invoking party experiences shipping delays as a result of one or more force-majeure events,

then:

☒ the invoking party may allocate its available goods or services to its customers in its discretion.

☐ the invoking party must allocate its available goods and/or services so that the customer under the Contract will receive at least the same proportion of those goods and/or services as the customer would have received in the absence of the force-majeure event.

### 22.62.7 Option: No Required Mitigation or -Remediation

> Neither party is obligated to make any efforts to mitigate and/or remediate the effects of the invoked force majeure.

*Commentary*

#### *22.62.7.1 Should mitigation and/or remediation be required?*

Note that there are two distinct possibilities presented here: One for *mitigation*, one for *remediation*, which are two different things. In a supply- or services agreement, the customer might not want to be bound by any obligation to respond to force majeure events.

Of course, a drafter should be careful not to commit a client to either mitigation or remediation efforts if such efforts are not part of the client's business model.

#### *22.62.7.2 Caution: "Best efforts" to mitigate / remediate?*

Some customers might want their suppliers to commit to using "best efforts" to mitigate or remediate the effects of force majeure.

> See, e.g., section 4 of a set of Honeywell purchase-order terms and conditions, apparently from February 2014.

A supplier, however, might be reluctant to agree to a best-efforts commitment because different courts might define that term in different ways; see the commentary in Tango Clause 22.20 - Best Efforts Definition.

### 22.62.8 Option: Extension of Expiring Right

> If one or more properly invoked events of force majeure make it impracticable or impossible for an invoking party to timely exercise a right under an agreement,
>
> > then the time for exercising that right will be deemed extended for the duration of the resulting delay.

*Commentary*

This Option addresses a gap (depending on one's perspective) in many force-majeure clauses: In one case, New York's highest court held that the force-majeure clause in question "does not modify the habendum clause and, therefore, the leases terminated at the conclusion of their primary terms."

Beardslee v. Inflection Energy, LLC, 25 N.Y.3d 150, 153, 31 N.E.3d 80, 8 N.Y.S.3d 618 (2015) (on certification from Second Circuit).

### 22.62.9 Option: Economic Out

An invoking party is considered not to be reasonably able (or not to *have been* reasonably able, as applicable) to avoid a failure of timely performance resulting from one or more force-majeure events if avoidance is (or was) not possible at a commercially reasonable cost.

### 22.62.10 Option: Mandatory Alerting

FILL IN PARTY NAME must promptly alert FILL IN PARTY NAME if the former concludes that a substantial risk exists that it might have to invoke force majeure.

### 22.62.11 **Option: Subcontractor Failure**

IF: A party invoking force majeure fails to timely perform its obligations (or exercise its rights) under the Contract;

AND: The invoking party's failure was due to a failure of a subcontractor or supplier;

THEN: The invoking party's failure will be excused only if both of the following are true:

1. The failure by the subcontractor or supplier otherwise qualifies as one or more force-majeure events; and

2. It was not reasonably possible for the invoking party to timely obtain, from one or more other sources, the relevant goods or services that were to have been provided by the subcontractor or supplier.

## Clause 22.63 Forum Selection

### 22.63.1 Applicability

This Clause applies if and when the Contract states that specified disputes may — or must — be brought in a particular court or jurisdiction (each, an "*Agreed Forum*").

*Commentary*

*22.63.1.1 Legal background*

In the U.S., federal courts routinely enforce forum-selection clauses "unless extraordinary circumstances unrelated to the case clearly disfavor a transfer."

Atlantic Marine Construction Co., Inc. v. United States District Court, 571 U.S. 49, 134 S. Ct. 568, 575, 187 L. Ed. 2d 487 (2013) (holding that transfer, not dismissal, was appropriate); The Bremen v. Zapata Off-Shore Co., 407 U.S. 1 (1972) (reversing and remanding Fifth Circuit decision; international contract's selection of London Court of Justice as exclusive forum was not unenforceable).

"[A] forum selection clause should be enforced unless the resisting party can show[:] [i] that enforcement would be unreasonable and unjust, or [ii] that the clause was invalid for such reasons as fraud or overreaching or [iii] that enforcement would contravene a strong public policy of the forum in which suit is brought, whether declared by statute or by judicial decision."

Rivera v. Centro Medico de Turabo, Inc., 575 F.3d 10, 18 (1st Cir. 2009) (affirming dismissal of action based on forum-selection clause), *in part quoting* M/S Bremen v. Zapata Off-Shore

Co., 407 U.S. 1, 10, 15 (1972) (internal quotation marks, alteration marks, and citations by 1st Cir. omitted; bracketed material added).

Likewise, *state* courts in the U.S. generally honor forum-selection provisions "unless the party challenging enforcement establishes that *such provisions* are unfair or unreasonable, or are affected by fraud or unequal bargaining power."

Paul Business Systems, Inc. v. Canon U.S.A., Inc., 97 S.E.2d 804, 807-08 (Va. 1990) (affirming dismissal of complaint) (emphasis added, extensive citations and internal quotation marks omitted).

#### *22.63.1.2 Failing to advise a client in writing about forum selection could get a lawyer in trouble*

In a UK case, an English sports executive was approached about signing on as CEO of an Indian company in the sports business. A Web page of a UK legal-malpractice law firm says that the executive's longtime London law firm had only three hours to draft the employment agreement. The court found that the law firm had failed to advise the executive to include a forum-selection clause in the draft to require litigation to be in England because of the notorious slowness of Indian courts. After much litigation, the end result was a £40,000 judgment *against the law firm* for the executive's wasted costs of trying to collect the judgment. **The lesson:** If the law-firm partner had advised the executive *in writing* about the desirability of including an English forum-selection clause, the case might never have gotten as far as it did. See Wright v. Lewis Silkin LLP, [2016] EWCA Civ 1308 ¶¶ 17-18, 39, 46.

#### *22.63.1.3 Additional terms to consider*

Drafters may want to consider also:

- Tango Clause 22.7 - Arbitration
- Tango Clause 22.57 - Escalation of Disputes
- Tango Clause 22.19 - Baseball Arbitration

### 22.63.2 Permitted forums

Any such specified dispute,

> if not required to be resolved by other means, such as, for example, arbitration (see Tango Clause 22.7 - Arbitration),
>
> may be heard in any Agreed Forum, regardless where the defendant is geographically located.

*Commentary*

#### *22.63.2.1 Language choice: "may be heard …."*

This section does not say that disputes must be *litigated* in an Agreed Forum, but only that disputes may be *heard* there — and even that language is non-exclusive, so as not to rule out:—

- filing a lawsuit in another venue, nor
- seeking a transfer of a case to another forum after its filing.

In one contract reviewed by the author, a forum-selection clause stated that "disputes are to be *resolved* in [a particular court]."

- This is an example of a false imperative (see Section 11.1: ).
- A better way to word the provision is to state it in terms of a positive obligation: "Any dispute arising out of … *must be brought and maintained in* [the court in question]."

#### *22.63.2.2 Cases "arising out of," but not "relating to," the agreement*

Drafters should be careful about specifying a forum for proceedings "relating to" the parties' agreement, as opposed to the narrower "arising out of" the agreement.

Here's a hypothetical example of why that might be a concern – suppose that:

- Provider licenses its software to Customer.
- The license agreement requires any litigation *arising from* the agreement to be brought in the city of Customer's principal place of business; let's assume that's Atlanta (Georgia, USA).
- One day, though, a different division of Customer, located in, say, Zion (Illinois, USA), rolls out a new product that:
  - performs some of the functions of Provider's software, and
  - bears a trademark that's confusingly similar to Provider's trademark.

In that situation, if Provider wanted to sue Customer *for trademark infringement*, then:

- Provider might well want to bring the lawsuit in *Zion* (vice Atlanta) because of the better availability of witnesses and documents,
- but Provider might not be able to do so if the license agreement required all disputes *relating to* the license agreement to be brought in *Atlanta*.

#### *22.63.2.3 Caution: Saying "the courts of a jurisdiction could be dangerous*

It can be dangerous to say that lawsuits may- or must be heard "in the courts *of*" the specified forum location. That's because a U.S. court might find that such language precluded the defendant from removing the suit from state court to *federal*

court. That happened in a Ninth Circuit case (where the appeals court also held that the forum-selection clause was unenforceable). See Doe 1 v. AOL, LLC, 552 F.3d 1077, 1081-82 (9th Cir. 2009) (per curiam).

#### *22.63.2.4 A court might not honor the parties' agreement to an improper forum*

In many American states, a statute specifies the location where a lawsuit must be brought. Typically, this will be either the county where the plaintiff resides or the county where the defendant resides.

If a contract's forum-selection clause specifies a county that does not meet the statutory requirement, a court might refuse to enforce the forum selection. This happened in a North Carolina case — although the court did note that "a forum selection clause which favored a court *in another State* was enforceable …." A&D Envt'l Serv., Inc. v. Miller, 770 S.E.2d 755, 756 (N.C. App. 2015) (affirming denial of defendant's motion to enforce forum-selection clause) (emphasis in original, citation and internal quotation marks omitted).

#### *22.63.2.5 And forum-selection clauses might be disregarded for policy reasons*

Courts will sometimes refuse to honor a contract's forum-selection clause if the clause offends a strong public policy of the forum location. Here are a couple of examples.

A group of users of the America OnLine (AOL) service sued AOL in California and sought class-action status.

- The AOL user agreement required all disputes to be litigated in Virginia.
- Citing the forum-selection clause, a federal district court in California dismissed the case but said it could be re-filed in Virginia state courts as required by the user agreement.
- The federal appeals court disagreed. It held that California had a strong public policy favoring class-action relief, and noted that such relief was not available in Virginia state courts. Therefore, said the appeals court, "the forum selection clause in the instant member agreement is unenforceable as to California resident plaintiffs bringing class action claims under California consumer law." Doe 1 v. AOL, LLC, 552 F.3d 1077, 1084 (9th Cir. 2009).

A Texas case had a very different outcome:

- AutoNation, a Florida-based car dealer, filed suit, in Florida, against a former employee who lived in Texas and had worked for the car dealer there.
- The former employee's employment agreement contained a choice-of-law clause calling for Florida law to apply, together with a forum-selection clause requiring any litigation to take place in Florida.
- Before learning of the Florida action, the former employee sued the car dealer in Texas, seeking a declaratory judgment that the non-competition covenant of

the employment agreement was unenforceable under prior Texas supreme court precedent.

- Granting a writ of mandamus, the Texas supreme court ruled that while it was not questioning the validity of its prior precedent, it would still enforce the "freely negotiated" *[sic]* forum-selection clause to allow the first-filed suit in Florida to proceed. See In re AutoNation, Inc., S.W.3d 663 (Tex. 2007).

QUESTION: On the *AutoNation* facts, what are the odds that the *Florida* court would have applied *Texas* law, given that the contract included a Florida choice-of-law clause?

For additional discussion and case citations, see generally Paulo B. McKeeby, Solving the Multi-State Non-Compete Puzzle Through Choice of Law and Venue (2012).

#### *22.63.2.6 **Caution:** China could be a special case*

Anyone drafting a contract with a Chinese counterparty should consider:

- whether the contract meets the language- and governing-law requirements of Chinese law to make the contract enforceable by a Chinese court; and
- if not, whether the counterparty has sufficient reachable assets in a more-friendly jurisdiction (because Chinese courts purportedly won't enforce foreign judgments or arbitration awards).

See generally Dan Harris, China Contracts That Work (2014), archived at https://perma.cc/DY8W-2CAY.

#### *22.63.2.7 Caution: A Massachusetts forum could be dangerous for defendants*

If a contract specifies Massachusetts as the forum state for litigating disputes, the defendant might find that its bank account and other assets have been "attached" even before trial if the plaintiff can show a likelihood of success on the merits. See Shep Davidson, When an Out-of-State Company Can Be Sued in Massachusetts and Why You Should Care (2013).

#### *22.63.2.8 Territory-specific choice of forum?*

Some companies' boilerplate terms include territory-specific choices of forum (and law). For example, here's a territory-specific forum provision from Carson Wagonlit Travel, at https://perma.cc/6RJK-57EM:

> 18.1 This Agreement shall be exclusively governed by the exclusive laws of [sic] *and all disputes relating to this Agreement shall be resolved exclusively* in[:]
>
> (i) England and Wales and governed by English law if the Seller's registered office is located in the Europe, Middle East, Africa (EMEA) region;
>
> (ii) Singapore if the Seller's registered office is located in Asia Pacific (APAC) region; or

> (iii) the State of New York, USA if the Seller's registered office is located the Americas region.

(Emphasis and extra paragraphing added.)

### 22.63.3 No exclusivity unless stated

An Agreed Forum is not exclusive unless the Contract unambiguously says so.

*Commentary*

#### *22.63.3.1 An exclusive-forum clause is a hand grenade: It might be thrown back*

Consider this not-so-hypothetical example:

- You're helping to negotiate a contract between your client, "Alice," and another party, "Bob."
- Your draft contract is a tough one; among other things, it contains an exclusive-jurisdiction forum clause that requires all litigation to be conducted in Alice's home-court jurisdiction.
- In negotiating the contract, Bob's counsel says, *sure, an exclusive-jurisdiction clause is fine with us — but the exclusive jurisdiction has to be* Bob's *home court, not Alice's.*

In that case, if Bob has more bargaining power, your proposal of a tough first-draft contract might have created problems for your client Alice.

Author's note: In a negotiation of a big commercial deal, the client had forwarded its standard form contract — which I hadn't written — to a prospective customer that had significantly-more bargaining power than my client did. The customer's lawyer saw the forum-selection clause, and said we needed to turn it around so that the exclusive forum would be the customer's home city. Fortunately, the customer's lawyer went along with my suggestion that we just drop the forum-selection clause entirely.

#### *22.63.3.2 An exclusive-forum clause might be tactically disadvantageous*

Back to our Alice-and-Bob hypothetical: Now imagine that Alice prevailed on Bob to accept an exclusive-jurisdiction forum clause, specifying that all litigation will be in Alice's home jurisdiction. And imagine that years (or days) after signing the contract, Alice wanted to seek a temporary restraining order or preliminary injunction against Bob.

That might be, for example, because Bob appeared to be violating a confidentiality clause requiring him to keep Alice's information secret.

In that case, Alice might well be better off suing Bob in his own home jurisdiction, because:

> In kicking off the lawsuit, it's likely that Alice will be able to complete the necessary service of process on Bob more quickly in his own home court.
>
> If Alice had to court to compel Bob to produce documents or witnesses, Bob would probably have a harder time resisting an order from a judge in Bob's own home jurisdiction.
>
> Even if Alice were successful in getting a court to issue an injunction affecting Bob, the injunction likely wouldn't take effect until it has been formally served on Bob; service might well be quicker and easier in Bob's home jurisdiction.
>
> if Bob violated the injunction, Alice probably would be able to haul him back more quickly into court for contempt proceedings in his own home jurisdiction.

So: Alice should think twice before insisting that Bob agree to exclusive jurisdiction in Alice's home court.

Moreover, asking for – or insisting on – a forum-selection clause might fall into the category of "be careful what you wish for," because the courts in the forum state might decide matters differently than what you expected. A Massachusetts company learned a painful lesson in that regard in *Taylor v. Eastern Connection Operating, Inc.*, discussed here.

#### *22.63.3.3 Caution: An exclusive forum might kill arbitration*

An explicit *exclusive* forum-selection provision in a contract might be held to trump an arbitration provision in a prior- or "background" agreement such as the arbitration provision in the rules of the Financial Industry Regulatory Authority ("FINRA"), a self-regulatory organization. At this writing there is a split in the circuits on that point:

- The Second and Ninth Circuits have held that an exclusive forum-selection clause *does* trump the arbitration provision in the FINRA rules. *See* Goldman, Sachs & Co. v. Golden Empire Schools Financing Authority, 764 F.3d 210 (2d. Cir. 2014), in which the appeals court affirmed a trial court's grant of Goldman's motion to enjoin FINRA arbitration, on

grounds that the forum-selection clauses in the parties' agreements superseded the arbitration provision (hat tip: Michael Oberman); *see also* Goldman, Sachs & Co. v. City of Reno, 747 F.3d 733, 736 (9th Cir. 2014), where the appeals court reversed a denial of preliminary injunction and final judgment on the same grounds.

• In contrast, the Fourth Circuit held that an exclusive forum-selection clause did *not* trump the arbitration clause in the FINRA rules, on grounds that the forum-selection clause referred to *litigation*, not arbitration, and "we believe that it would never cross a reader's mind that the *[forum-selection]* clause provides that the right to FINRA arbitration was being superseded or waived." UBS Fin. Servs., Inc. v. Carilion Clinic, 706 F.3d 319, 329-30 (4th Cir. 2013); *see also* UBS Sec. LLC v. Allina Health Sys., No. 12–2090, 2013 WL 500373 (D. Minn. Feb. 11, 2013) (following *Carilion Clinic*).

• In a similar vein was Narayan v. Ritz Carlton Dev. Co., 100 Haw. 343, 400 P.3d 544 (2015), in which a condominium purchase agreement said that venue for litigation would be in a specified court in Hawaii, but the purchase agreement incorporated a condominium declaration, which contained an arbitration clause. The Hawaii supreme court ruled that this inconsistency meant that the arbitration clause was unenforceable. (The court also held that the arbitration clause was unconscionable because it prohibited discovery and punitive damages.)

• In an oddball case, a forum-selection provision in an earlier contract was "held over," and trumped an arbitration provision in a successor contract, because the arbitration language was of narrower scope. See Garthon Bus. Inc. v. Stein, 2016 NY Slip Op 3102 (reversing order compelling arbitration).

#### *22.63.3.4 Caution: "Shall be subject to"*

In an English case, a Hong Kong freight forwarder used its standard bill-of-lading form in accepting cargo for shipment from China to Venezuela. The form provided in part that "[t]his Bill of Lading and any claim or dispute arising hereunder *shall be subject to* English law and the jurisdiction of the English High Court of Justice in London." The UK Court of Appeal, after reviewing case law concerning similar language, held that the bill of lading's wording conferred *exclusive* jurisdiction on the English courts. Hin-Pro International Logistics Limited v Compania Sud Americana De Vapores S.A. [2015] EWCA Civ 401 ¶¶ 4, 61-78 (emphasis added). (Hat tip: Mark Anderson, who in his write-up makes additional observations about the case.)

#### 22.63.4 Transfers

If the Contract unambiguously says that an Agreed Forum is exclusive, then no party may seek to transfer a dispute that is brought there.

## Clause 22.64 Franchise-Law WAIVER

The parties do not intend for anything in the Contract to be construed as making any party a franchisee of the other party,

> and each party WAIVES (see the definition in Clause 22.162) the benefit of any state or federal statutes dealing with the establishment and regulation of franchises.

*Commentary*

In some jurisdictions, this waiver will be unenforceable or even void; see, e.g., California's Franchise Investment Law at Cal. Corp. Code § 31512: "Any condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law or any rule or order hereunder is void."

Even so, language like this is still sometimes seen in contracts

## Clause 22.65 Fraud Proof

a. Any assertion that a person committed or engaged in fraud must be established by showing — in addition to any other required elements — one or both of the following:

1. that the person made an untrue statement of a material fact *with knowledge* of the statement's untruth; or

2. that the person omitted a material fact with knowledge that the material fact was necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

b. Each element of proof of fraud must be supported by clear and convincing evidence (see the definition in Clause 22.30),

which must include reasonable corroboration (see the definition in Clause 22.38) of any testimony by an interested witness.

c. The fraud-proof requirements of subdivision a and b apply, without limitation, to any claim of fraud made in any Agreement-Related Dispute (see the definition in Clause 22.3),

without regard to whether the claim purports to arise under contract law, tort law, strict liability law, statutory law, or otherwise.

d. In case of doubt: each party WAIVES (see the definition in Clause 22.162) any claim of fraud that is not proved in accordance with the fraud-proof requirements of this Clause.

Commentary

### 22.65.1 Legal background

In American jurisprudence, allegations of fraud must be pleaded with particularity, see, e.g., Federal Rule of Civil Procedure 9(b), and typically must be proved by clear and convincing evidence (see the definition in [NONE]) and not just by a preponderance of the evidence.

### 22.65.2 Subdivision a: Proof requirements

These specific fraud-proof requirements are adapted from the definition in Rule 10b-5 of the U.S. Securities and Exchange Commission; see generally the Wikipedia article "Rule 10b-5."

### 22.65.3 Subdivision b: Clear and convincing evidence

This requirement is based on the widely-applied (but not universally-followed) standard for proof of fraud (in civil cases) in U.S. law. See, e.g., New York Pattern Jury Instruction 3:20, *cited in* H.J. Heinz Co. v. Starr Surplus Lines Ins. Co., No. 15cv0631, slip op. at 5 (W.D. Pa. Oct. 30, 2015) (adopting clear and convincing evidence standard for jury instructions).

## Clause 22.66 Freedom of Action

a. When this Clause is adopted in an agreement ("*the Contract*"), it applies as set forth in [BROKEN LINK: tango-which][BROKEN LINK: tango-which].

b. Neither party will assert, and each party WAIVES (see the definition in Clause 22.162) any claim or other assertion, that the Contract:

> obligates any party to enter into any other agreement, relationship, or transaction — see also [NONE],
>
> > or precludes any party from doing any kind of business with anyone else — see also [NONE],
> >
> > or requires any party to restrict the assignment of employees or other personnel,
>
> unless the Contract clearly states otherwise.

*Commentary*

This is a roadblock provision, intended to forestall claims by a party that another party *implicitly* agreed to restrict its activities.

## Clause 22.67 Gender Usage Definition

When necessary, any gender-specific or gender-neutral term in the Contract or any associated document, for example (see the definition in Clause 22.59), *he*, *she*, *it*, etc., is to be read as referring to any other gender, or to no gender, as appropriate, unless the context clearly requires otherwise.

*Commentary*

**Caution:** This Definition is representative of provisions used "back in the day" but that nowadays could be read by some as being implicitly offensive.

See, e.g., Shainul Kassam, Gender neutral contracts are here (LinkedIn.com Feb. 21, 2019).

Drafters might want instead to use gender-neutral language throughout — certainly when drafting a form for repeated use with parties who are individuals, such as standard-form employment agreements.

*Before:* Employee will keep *his* personal protective equipment (PPE) properly stored in *his* locker when *he* is not at work.

*After (alternatives):*

1. Employee will keep *Employee's* personal protective equipment (PPE) properly stored in *Employee's* locker when *Employee* is not at work.

2. *You* must keep *your* personal protective equipment (PPE) properly stored in *your* locker when *you* are not at work.

3. Keep *your* personal protective equipment (PPE) properly stored in *your* locker when *you're* not at work. *(This might need extra language to be clear that imperative sentences are intended to be binding.)*

## Clause 22.68 General Representations

### 22.68.1 Introduction

Each party represents (see the definition in Clause 22.134), to each other party, that the statements in this Clause are true.

*Commentary*

This Clause provides a "canary in the coal mine" to help the parties identify (and, ideally, address) certain problems *before* they sign the Contract.

Note that the statements in this Clause are *representations*, not warranties; see generally Section 13: for a discussion of the differences.

Some strategically-important types of agreement include more-detailed representations *and* warranties of this general kind. See, for example, the merger agreement between United Airlines and Continental Airlines, at https://tinyurl.com/UAL-CAL (SEC.gov), from which some of the concepts in this Clause are drawn.

### 22.68.2 No known conflicts

Each party represents,

to each other party,

that — so far as the representing party is aware — *the representing party*:

1. is not a party to any "problematic" (as defined below) agreement with any third party;

2. is not the target of any "problematic" claim, in litigation or otherwise; and

3. is not subject to any "problematic" injunction, judgment, or regulatory restriction,

where a "problematic" thing is one whose effects — alone or in combination with other things — could reasonably be regarded as posing a risk of materially interfering with *any* party's (i) performance under the Contract or (ii) exercise of its rights under the Contract.

*Commentary*

Suppose (for example) that *A* enters into a contract with *B*, under which *B* will provide certain services. Conceivably, *B* might have previous commitments that could interfere with *B*'s timely carrying out its obligations to *A*; that in turn could adversely affect *A*'s own business operations. SO: Before signing the Contract, *A* might want some assurance from *B* as stated above.

Language origins: The above representation is adapted from portions of sections 3.3(b) and 3.9 of the United Airlines merger agreement cited above.

Note that this representation is fairly limited — it **doesn't** say, for example, that a party commits to not entering into any other agreement that might conflict with the Contract.

### 22.68.3 No known tortious interference

By entering into the Contract, each party represents, to each other party, that so far as the representing party is aware,

neither the parties' entry into the Contract, nor their respective performances under it,

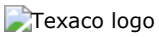
will constitute tortious interference, on the part of any party to the Contract:

1. with a contract between the representing party and any third party, nor

2. with the prospective economic advantage of any third party.

*Commentary*

See generally the Wikipedia discussion of tortious interference with contractual relationship or prospective economic advantage.




A tortious-interference lawsuit can have catastrophic results. For example: Oil giant Texaco was hit with a damage award of some $10.5 billion, or more than $27 billion in 2019 dollars, for tortiously interfering with what the jury and the courts found to be a binding memorandum of understanding between Pennzoil and Getty Oil. See Texaco, Inc. v. Pennzoil Co., 729 S.W.2d 768 (Tex. App.—Houston [1st Dist.] 1986, writ. ref'd n.r.e.).

## Clause 22.69 Good Faith Definition

a. *Good faith* refers to conduct that both:

1. is honest in fact, and

2. comports with reasonable commercial standards of fair dealing in the trade.

b. This Definition does not in itself impose any duty of good faith on any party.

*Commentary*

This definition is a blend of:

1. Restatement of Contracts (Second) § 205, which states: "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement"; and

2. Uniform Commercial Code § 1–304, which imposes a duty of good faith on all contracts and duties within the UCC, and § 2-103(b), which defines *good faith* (in the case of a merchant) as "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."

The term *good faith* is defined here because, as the U.S. Supreme Court has observed, "it does not appear that there is any uniform understanding of the doctrine's precise meaning. … [W]hile some States are said to use the doctrine to effectuate the intentions of parties or to protect their reasonable expectations, other States clearly employ the doctrine to ensure that a party does not violate community standards of decency, fairness, or reasonableness."

Northwest, Inc. v. Ginsberg, 572 U.S. 273, 134 S. Ct. 1422, 1431, at part III (2014) (cleaned up; extensive citations omitted).

**Caution:** Unlike the law many other states, Texas law does not impose a *general* duty of good faith and fair dealing in contractual relationships. As explained by the Fifth Circuit, such a duty arises only in specific, limited circumstances.

See Hux v. Southern Methodist University, 819 F.3d 776, 781-82 (5th Cir. 2016) (affirming dismissal of former student's tort claim against professor); Subaru of America, Inc. v. David McDavid Nissan, Inc., 84 S.W.3d 212 (Tex. 2002): "A common-law duty of good faith and fair dealing does not exist in all contractual relationships. Rather, the duty arises only when a contract creates or governs a special relationship between the parties." (Cleaned up, citations omitted.)

## Clause 22.70 Governing Law

a. *Applicability:* IF: The Contract specifies a governing law (the "*Governing Law*," or "choice of law," which is intended to mean the same thing); THEN: The substantive Governing Law (as distinct from the procedural governing law) is to apply in any Agreement-Related Dispute (see the definition in Clause 22.3).

b. *No renvoi:* The Governing Law is to be applied without regard to conflicts-of-law rules that might otherwise result in the application of the law of some other jurisdiction.

c. *Arbitral law:* If the Contract requires arbitration (see [NONE]) of some or all disputes, then any such arbitration is to be governed by the Governing Law UNLESS the arbitration agreement expressly pro-

vides for a different arbitral law, in which case the specified arbitral law will govern.

d. *Exclusions:* The Contract may exclude one or more laws, to the extent not prohibited by law.

Commentary

### 22.70.1 Context

It's quite common for a contract to specify a law to govern the contract — or possibly just one specific clause of a contract, see Section 22.70.14: — and/or the parties' relationship generally; this is discussed in detail at [BROKEN LINK: GovLaw-cmt][BROKEN LINK: GovLaw-cmt][BROKEN LINK: GovLaw-cmt].

### 22.70.2 Subdivision a: To *what* does the Governing Law apply?

A choice-of-law clause that applies only to the *interpretation* and *enforcement* of a contract will probably not govern tort-based claims such as claims of misrepresentation, e.g., of fraudulent inducement to enter into the contract. See, e.g., ACI Worldwide Corp. v. KeyBank N.A., No. 1:17-cv-10662-IT, slip op. at 5-7 (D. Mass. Sept. 30, 2020).

### 22.70.3 Subdivision b: No *renvoi*

Renvoi/ is a legalese term for a ping-pong application of a choice of law. An analogous issue came up in an Idaho case, where a contract expressly required arbitration in Dallas, but the Idaho supreme court held that the agreement's choice of Texas *law* required arbitration in *Idaho*. See T3 Enterprises, Inc. v. Safeguard Bus. Sys., Inc., 435 P.3d 518, 528-30 (Idaho 2019).

### 22.70.4 Subdivision c: Arbitral law

Suppose that the Contract specified Texas law for general purposes, but New York law for arbitration. In that case, any arbitration under the Contract would be governed by New York law — and, if applicable, the U.S. Federal Arbitration Act. See also [NONE] (arbitral law).

### 22.70.5 Subdivision d: Exclusions

It's not uncommon for parties to exclude, e.g., the United Nations Convention on Contracts for the International Sale of Goods ("UN CISG" or "Vienna Convention"). That convention, in some ways, amounts to an international version of the U.S. Uniform Commercial Code, with nontrivial differences. See generally the Wikipedia article on the UN CISG; for a comparison of the UCC and the UN CISG, see John C. Tracy, UCC and CISG (Jul. 5, 2011).

Another possible exclusion is the Uniform Computer Information Transactions Act ("UCITA"), which is (was?) a controversial proposed uniform law that was enacted only in Maryland and Virginia, and and otherwise appears to be essentially dead. See generally the Wikipedia article on UCITA.

### 22.70.6 Substantive- vs. procedural choice of law

A contract's choice of governing law will generally apply only to *substantive law*, not to procedural matters such as statutes of limitation. A Texas appeals court summarized the law in some jurisdictions:

> In Texas, statutes of limitations are procedural. Delaware law similarly states that choice-of-law provisions in contracts do not apply to statutes of limitations, unless a provision expressly includes it. If no provision expressly includes it, then the law of the forum applies because the statute of limitations is a procedural matter. *Choice of law provisions in contracts are generally understood to incorporate only substantive law, not procedural law* such as statutes of limitation.

Integrity Global Security, LLC v. Dell Marketing LP, 579 S.W.3d 577, 587 (Tex. App.–Austin 2019) (reversing summary judgment that limitation period had expired) (cleaned up, emphasis added), *pet. granted*, No. 19-0787 (Tex. Oct. 2, 2020), joint motion to abate, based on settlement, granted (Tex. Dec. 18, 2020).

### 22.70.7 A court might disregard a problematic choice of law

A court might not give effect to a governing-law clause in a contract if doing so would lead to a result that contravened a fundamental public policy of the law of the jurisdiction in which the court sits. Here are some examples:

EXAMPLE: In New York, a non-solicitation provision in an employment agreement (as in, *no soliciting our customers after you leave*), purporting to bind an employee in that state, is judged by New York law, not the governing law stated in the employment agreement. See Brown & Brown, Inc. v. Johnson, 25 N.Y.3d 364, 34 N.E.3d 357, 12 N.Y.S.3d 606 (2015) (affirming, in pertinent part, judgment that choice-of-law clause was unenforceable in respect to non-solicitation clause).

EXAMPLE: A medical-device sales representative quit his job in Arizona and started working for a direct competitor of his former company. So, the former company filed a lawsuit in federal court in Arizona. The former company wanted to enforce a non-competition covenant in the sale rep's employment agreement; it asked the court for an immediate temporary restraining order (TRO) to prohibit the sales rep from working for the competitor. The Arizona federal court refused to grant the requested restraining order; the court recognized that the employment agreement's governing-law clause specified that the law of Washington state would apply, but said that in this area the laws of Arizona gave more weight to employees' right to earn a living than did Washington law, and this was an area of fundamental public policy for Arizona law. Consequently, the court refused to give effect to the agreement's choice of *Washington* law — and the court held that under *Arizona* law, the sales rep's non-competition covenant was unenforceable. See Pathway Medical Technologies, Inc. v. Nelson, No. CV11-0857 PHX DGC (D. Ariz. Sept. 30, 2011).

EXAMPLE: A California truck driver sued the Texas-based trucking company for which he worked for violating California employment law. The driver's contract with the company specified that Texas law would apply and said that the driver was an independent contractor, not an employee. The Ninth Circuit held that California courts would not give effect to the contract's choice of Texas law, but instead would apply California law — and under *California* law, said the appeals court, the driver was really an employee, not an independent contractor, and therefore could properly sue the trucking company for vio-

lating California employment law. See Narascyan v. EGL Inc., 616 F.3d 895 (9th Cir. 2010) (reversing district court holding).

EXAMPLE: A Maine-based sales representative was employed by a California company. The sales rep's employment agreement included a California choice-of-law clause. The company failed to pay commissions on certain sales. The First Circuit held that *Maine* law governed — and therefore the sales rep was entitled, not only to back commissions, but also to treble damages and attorney fees under a Maine statute. See Dinan v. Alpha Networks, Inc., 764 F.3d 64 (1st Cir. 2014) (vacating trial-court judgment that applied California law after jury verdict in favor of sales rep).

### 22.70.8 But: A court might *give effect* to a problematic choice of law

Contrary to the above examples, a court might give effect to a contract's choice of law even if a party claimed that the choice contravenes a fundamental public policy.

For example, the Supreme Court of *Texas* held that it was permissible for ExxonMobil to choose New York law for its employee stock-option and restricted-stock programs, because multi-national companies should be able to choose the laws they want to follow, in the interest of uniformity. See Exxon Mobil Corp. v. Drennen, 452 S.W.3d 319 (Tex. 2014).

(OK, the "choose the laws they want to follow" part does overstate the court's holding just a bit, but not by much; the court arguably opened the door for corporations to purport to impose onerous terms and conditions on their employees while using a choice-of-law clause to strip the employees of their legal protections.)

### 22.70.9 A statute might explicitly negate a choice of law

In a given jurisdiction, a statute might *require* a court of that jurisdiction to disregard a contract's choice of law. EXAMPLE: Under the Minnesota Termination of Sales Representatives Act, choice-of-law provisions that violate a specified subdivision of the Act are void and unenforceable. See Engineered Sales Co. v. Endress + Hauser, Inc., No. 19-1671, slip op. at 2 (8th Cir. Nov. 17, 2020) (reversing and remanding summary judgment), *citing* Minn. Stat. § 325E.37.

### 22.70.10 Which governing law to choose?

Drafters wondering which governing law to choose should give some thought to the specifics of the laws being considered.

• Several years ago the author started a choice-of-law cheat sheet for U.S. states that might be helpful (although it has not been worked on in a long time).

• In international transactions, a party from a jurisdiction with a civil code (e.g., continental Europe; Latin America) might be reluctant to agree to the law of a common-law country (e.g., England and its former colonies), or vice versa. In that situation, the UN CISG (discussed below) might be an acceptable "neutral" choice.

• English law is often chosen for multi-national transactions. See, e.g., Melanie Willems, English Law – a Love Letter (mondaq.com 2014), which contrasts England's common-law foundation with the civil law found on the Continent.

• Different laws might be suited for different industry categories. See generally Thierry Clerc, International Contracts: From choosing applicable law to settling disputes (Euro-Juris.net 2016), archived at https://perma.cc/U54S-QMBH.

### 22.70.11 Choose the law of the agreed forum?

If the parties are also going to agree to a choice of forum — about which see Tango Clause 22.63 - Forum Selection — then they might want to choose the law of the agreed forum as their governing law. That could increase the chances of having their choice of law enforced in a dispute.

For example: the parties might agree to New York law, in part to take advantage of the statutory provision validating clauses requiring amendments to be in writing in certain contracts (see Tango Clause 22.4 - Amendments and its commentary). A New York court would seem to be more likely to give effect to that provision, and thus to an amendments-in-writing clause, than might a court in another jurisdiction.

### 22.70.12 Territory-specific choice of law?

Some companies' boilerplate terms include territory-specific choices of law (and forum selections). For example, here's a territory-specific governing law provision from Carson Wagonlit Travel, at https://perma.cc/6RJK-57EM:

> 18.1 This Agreement shall be exclusively governed by *the exclusive laws of* [sic] and all disputes relating to this Agreement shall be resolved exclusively in[:]
>
> (i) England and Wales and governed by English law if the Seller's registered office is located in the Europe, Middle East, Africa (EMEA) region;
>
> (ii) Singapore if the Seller's registered office is located in Asia Pacific (APAC) region; or
>
> (iii) the State of New York, USA if the Seller's registered office is located the Americas region.

(Emphasis and extra paragraphing added.)

### 22.70.13 Caution: China could present issues for choice-of-law provisions

At the China Law Blog, Dan Harris asserts that *as a practical matter*, Chinese courts:

- will not enforce a contract unless the contract is written in Chinese and the governing law is Chinese;
- will not enforce judgments of other nations' courts in contract lawsuits; and
- are unlikely to enforce arbitration awards from non-Chinese jurisdictions.

See generally Dan Harris, China Contracts That Work (2014), archived at https://perma.cc/DY8W-2CAY.

### 22.70.14 Choose different laws for different purposes?

It might seem strange to specify a choice of law to govern just one particular provision in a contract. But it's not unheard of; for example:

• The 1988 update to the Restatement (Second) of Conflicts of Laws states that "the parties may choose to have different issues involving their contract governed by the local law of different states." The comment cites a Maryland case in which loan documents for a real-estate project adopted local Maryland law for interest- and usury issues but New York law for others. See Restatement (Second) of Conflicts of Laws, comment i to § 187, citing Kronovet v. Lipchin, 288 Md. 30, 415 A.2d 1096 (1980).

• In its famous *Akorn v. Fresenius* decision, the Delaware chancery court observed: "The parties … chose *Delaware* law to govern the Merger Agreement *(excluding internal affairs matters governed by Louisiana law)* ….." Akorn, Inc. v. Fresenius Kabi AG, No. 2018–0300–JTL, slip op. at 11 n.14 (Del. Ch. Ct. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018).

• The EU's Rome I Regulation on contractual obligations states in Article 3.1 that "… By their choice the parties can select the law applicable to the whole or to part only of the contract."

• An international contract might specify that it is to be governed by the laws of, say, Brazil, but that any arbitration is to be "[BROKEN LINK: arb-loc]" in England, which might well mean that the arbitration proceedings would be governed by English law. That was precisely the holding of an English court; see Sulamerica CIA Nacional De Seguros SA & Ors v Enesa Engenharia SA & Ors, [2012] EWCA Civ 638, discussed in Sherina Petit and Marion Edge, The governing law of the arbitration agreement Q&A, in Norton Rose Fulbright, Int'l Arbitr. Rpt. 2014 – issue 2.

### 22.70.15 A governing-law clause might backfire

Specifying the law that you want to govern your contract, or your contractual relationship, might lead to unexpected (and undesired) results. Here are some real-world examples:

• A group of couriers, working in New York as couriers for a Massachusetts-based company, sued the company in Massachusetts for unpaid overtime. These New-York based couriers claimed to be entitled to the protection of *Massachusetts* statutes governing independent contractors, wages, and overtime.

Normally, people who file employment-type lawsuits against their companies tend to do so in their own home jurisdictions. That's understandable; the home-court advantage is not to be sneezed at – and it's also why companies like for their contracts to specify their home court for any lawsuits.

Well, that's just what had happened here: the courier company had used a standard form for its contracts with its New York courier personnel. The contract form stated that Massachusetts law would apply and that all disputes would be litigated in Massachusetts.

When confronted by an actual employee lawsuit in the forum it had specified, the company moved to dismiss the case — and the Massachusetts trial court granted the motion — on theory that the employment laws of Massachusetts did not apply to people who worked in New York.

The Massachusetts supreme court disagreed; it reversed the trial court's decision, giving an interim win to the New York-based courier personnel. The supreme court held that it

would not be unfair to enforce the courier company's own forumselection and governing-law clauses against the company.

Moreover, said the supreme court, enforcement of those clauses would not contravene a fundamental policy of the state of New York, where the couriers actually worked. The supreme court said that the trial court would need to conduct an evidentiary hearing to determine whether, on the facts of the case, the forum-selection and governing-law clauses should be enforced. The court remanded the case to the trial court for further proceedings.

See Taylor v. Eastern Connection Operating, Inc., 465 Mass. 191 (2013).

• A *Florida*-based, remote-working employee of a failed Massachusetts company successfully sued the company's CEO — personally — for more than $100,000 in unpaid wages and expense reimbursements, among other amounts. The employee did so under a Massachusetts statute that created the right of action, in part because the Florida-based employee's employment agreement stated that *Massachusetts* law applied.

See Dow v. Casale, 83 Mass. App. Ct. 751, 989 N.E.2d 909, 913 (2013) (affirming summary judgment in favor of former employee).

But a federal district court in Oklahoma, considering the same Massachusetts statute, distinguished the *Dow* opinion and dismissed the class-action claims filed by two remote employees; in that case, unlike *Dow*, the employment agreement did not include a choice-of-law provision.

See Goode v. Nuance Communications, Inc., No. 17-CV-00472-GKF-JFJ, slip op., text accompanying n.5 (N.D. Okla. Jul. 10, 2018).

• In a Canadian franchise-dispute case, an appeals court held that Ontario law — which gave franchisees specific rights — applied *even to franchisees outside Ontario* because the franchise agreement specified that Ontario law would apply.

See 405341 Ontario Ltd. v. Midas Canada Inc., 2010 ONCA 478 ¶¶ 40-45.

• BUT: A federal district court in San Francisco held that Uber drivers working outside California could not sue the company for violation of a California wage-and-hour statute, even though the drivers' contract with Uber included a California choice-of-law clause, on grounes that the relevant statutes did not apply extraterritorially.

See O'Connor v. Uber Tech., Inc., 58 F. Supp. 3d 989, 1003-06 (N.D. Cal. 2014) (granting judgment on the pleadings). (The extensive subsequent proceeding in that case are not relevant to this point; see O'Connor v. Uber Tech., Inc., 904 F.3d 1087 (9th Cir. 2018).)

### 22.70.16 A too-narrow governing-law clause can lead to surprises

Some governing-law clauses state (for example) that "*this Agreement* is to be governed by" the law of a particular jurisdiction. That might mean that other, non-contract claims are governed by the laws of the forum, not the law specified by the contract.

*Example:* A married couple brought an arbitration claim against its investment firm. The parties' contract contained a choice of Massachusetts law, but that choice of law applied only to the *interpretation* and *enforcement* of the contract, not to *related* claims. The client's claims against the investment firm included not only contract claims, but also claims under a Pennsylvania unfair-trade-practices statute. The arbitrator held that, be-

cause the contract's choice-of-law provision did not apply to *noncontract* claims, the Pennsylvania statute was available to the client; the arbitrator awarded treble damages under the Pennsylvania statute. The court upheld the (sizeable) arbitration award.

See Family Endowment Partners, L.P. v. Sutow, No. 2015 CV 1411- BLS1 (Mass. Superior Ct. Nov. 16, 2015) (confirming arbitration award); Pat Murphy, $48M arbitration award vs. investment advisor upheld (McCarter.com 2015).

*Example:* A Maine-based sales representative was employed by a California company. The sales rep's employment agreement included a California choice-of-law provision — but that provision stated only that "[t]he terms of this letter [agreement]" are to be "governed by and construed and enforced" under California law. When the company failed to pay commissions on certain sales, the sales rep's lawsuit against the company included a *non*-contract claim (quasi-contract, to be precise). The First Circuit held that the sales rep's non-contract claim did not require construction or enforcement of the terms of the agreement — and so *Maine* law, not California law, governed that claim, and therefore the sales rep was entitled, not only to commissions, but also to treble damages and attorney fees under a Maine statute.

See Dinan v. Alpha Networks, Inc., 764 F.3d 64, 67 (1st Cir. 2014) (vacating trial-court judgment that applied California law after jury verdict in favor of sales rep).

*Example:* A Canadian software company had too narrow a choice of Canadian law in its end user license agreement ("EULA") and, as a result, found itself forced to defend a class-action lawsuit in Chicago instead of in Victoria, B.C. The court noted that the EULA's governing-law provision applied only to the EULA per se and did not encompass the plaintiff's Illinois-law claims; this, said the court, tipped the balance in favor of keeping the case in Chicago.

See Beaton v. SpeedyPC Software, No. 13-cv-08389 (N.D. Ill. June 5, 2015) (denying defendant's motion to dismiss for forum non conveniens) (subsequent history omitted; see 907 F.3d 1018 (7th Cir. 2018).

### 22.70.17 Further reading

See generally (the extremely-useful) John F. Coyle, The Canons of Construction for Choice of Law Clauses, 92 Wash. L. Rev. 631, 648-55 (2017).

## Clause 22.71 Government Authority Definition

a. The terms *government authority* and *governmental authority* refer to any individual or group, anywhere in the world, that exercises *de jure* or *de facto* governmental- or regulatory power of any kind.

b. The terms should normally be read as including, as applicable and without limitation:

> any agency; authority; board; bureau; commission; court; department; executive; executive body; judicial body; legislative body; or quasi-governmental authority,
>
> at any level, for example, state, federal or local.

c. The governmental- and regulatory power referred to here is intended to include, without limitation, administrative; executive; judicial; legislative; policy; regulatory; and/or taxing power.

## Clause 22.72 Government Subcontract Disclaimer

Each party represents and warrants to the other that the Contract is not a subcontract of a contract between the representing party and any governmental entity.

*Commentary*

This section is a "no surprises" provision: Subcontracts to government contracts might include mandatory "flowdown" obligations as a matter of law; neither party wants to be surprised to learn that the Contract includes such flowdown obligations.

See also the discussion of "Flowdown requirements" in [NONE].

Of course, entire books have been written about government contracting and subcontracting; this section is intended merely to "smoke out" any need to address issues that could arise in such contracts.

## Clause 22.73 Gross Negligence Definition

a. *Gross negligence* refers to conduct that evinces a reckless disregard for or indifference to the rights of others,

tantamount to intentional wrongdoing;

it differs in kind, not only in degree, from ordinary negligence.

b. An assertion of gross negligence must be proved by clear and convincing evidence (see the definition in Clause 22.30).

*Commentary*

This definition adopts a middle-ground standard set out by the Court of Appeals of New York (that state's highest court).

See Sommer v. Federal Signal Corp., 79 N.Y.2d 540, 554 (1992).

In contrast: A Texas statute sets the bar for *gross negligence* quite high, for purposes of liability for punitive damages:

> (11) "Gross negligence" means an act or omission:
>
> (A) which when viewed objectively from the standpoint of the actor at the time of its occurrence involves an extreme degree of risk, considering the probability and magnitude of the potential harm to others; and
>
> (B) of which the actor has *actual, subjective awareness* of the risk involved, but nevertheless proceeds with *conscious indifference* to the rights, safety, or welfare of others.

Tex. Civ. Prac. & Rem. Code 41.001(11). The definition is used in § 41.003 of the Code, which conditions any award of punitive damages on a showing, by clear and convincing evidence, of fraud, malice, or gross negligence.

More vaguely, the California supreme court noted that *gross negligence* "long has been defined in California and other jurisdictions as either a want of even *scant* care or an *extreme* departure from the ordinary standard of conduct."

City of Santa Barbara v. Janeway, 62 Cal. Rptr. 3d 527, 161 P.3d 1095, 41 Cal. 4th 747 (2007) (cleaned up, emphasis added).

In the litigation over the notorious "BP oil spill" in the Gulf of Mexico, a federal district court wrote at length about the definition of *gross negligence* in the context of a federal statute; the court held that gross negligence was less than reckless conduct (much as in the California definition discussed above).

See In re: Oil Spill by the Oil Rig "Deepwater Horizon" in the Gulf of Mexico, on April 20, 2010, 21 F. Supp. 3d 657, 732-34 ¶¶ 481 et seq., esp. ¶¶ 494 & n.180, 495 (E.D. La. 2014) (findings of fact and conclusions of law).

Subdivision b: clear and convincing evidence (see the definition in Clause 22.30) is the same standard as is required in many jurisdictions for proof of fraud.

See, e.g., Goodyear Tire & Rubber Co. v. Rogers, 538 SW 3d 637, 644-45 (Tex. App.—Dallas 2017, pet. denied) (upholding judgment on jury verdict; allegation of gross negligence requires

proof by clear and convincing evidence) (citing cases).

# Clause 22.74 Guaranties

## 22.74.1 Introduction; parties

a. When this Clause is agreed to, it applies when, under the Contract, a party (the "*Guarantor*") guarantees a payment obligation (a "*Guaranteed Payment Obligation*") that is owed to another party (the "*Creditor*") by a third party (the "*Debtor*") under an agreement (the "*Guaranteed Agreement*").

b. The Guarantor's guaranty obligation is referred to as the "*Guaranty*."

c. For convenience, this Clause refers to a single Guarantor and a single Creditor — but the terms of this Clause apply in the same way when there are multiple Guarantors and/or multiple Creditors.

d. In case of doubt, the Contract may be a standalone guaranty agreement.

*Commentary*

### *22.74.1.1 Parties; spelling*

Subdivision a: Guaranties should be clear about just whose obligations are being guaranteed; a creditor's aggressive position on this issue could lead to litigation, as happened — somewhat brazenly, in the present author's view — in a Fifth Circuit case.

See McLane Foodservice, Inc. v. Table Rock Restaurants, LLC, 736 F.3d 375 (5th Cir. 2013).

Subdivision b — spelling: Traditionally, "guaranty" is the noun, while "guarantee" is the verb.

See, e.g., Uhlmann v. Richardson, 287 P.3d 287 (Kan. App. 2012), *citing* Bryan Garner, Garner's Dictionary of Legal Usage 399 (3d ed. 2011).

### *22.74.1.2 Background: Guaranty basics*

Guaranties typically cover *payment* obligations; guaranties of performance of other types of obligation — for example, an obligation to perform consulting services, repair work, building construction, etc. — might well require considerably-more negotiation and customized language.

For example: When the author's daughter was a college student with no non-parental income, I had to sign a guaranty for her apartment lease — the landlord wanted to be sure the rent got paid.

#### *22.74.1.3 Why guaranties?*

Creditors almost universally: • want their money when it's due; • *don't* want to have to spend time and money chasing after money owed to them; and • like to have backup sources of payment to go after in case a primary debtor fails to pay.

Hence, a creditor might want a third party to guarantee a primary debtor's payment.

#### *22.74.1.4 A drafter's checklist for guaranties*

Drafters of guaranties should consider the following issues:

1. *Is the guaranty to be of payment, or of (eventual) collection* after collection efforts against the debtor have been exhausted? [NONE] explicitly makes the former option the "default" choice, but [NONE] provides ground rules in case the Contract specifies otherwise.

2. *What law will govern the guaranty?* New York law is a common choice, especially for corporate-finance guaranties, so [NONE] makes that law the "default" choice.

3. *Where can the guaranty be enforced?* If you're a guarantor in the United States, under the Constitution you normally can't be sued for payment in, say, North Dakota if you don't have "minimum contacts" with that state. But there's an exception: *You can agree*, in what's called a "forum selection clause" (see [NONE]), that another party is allowed to sue you in a given state.

   See, e.g., Knauf Insulation, Inc. v. Southern Brands, Inc., 820 F.3d 904, 906 (7th Cir. 2016) (affirming judgment that guarantors were liable for payment obligations) (Posner, J) (citing cases).

   - Corporate-finance instruments often specify that guarantors can be sued in New York City. This is done because the right to payment is often sliced, diced, and sold to other parties. With an NYC forum-selection, successive buyers of the payment rights will know that they can sue for payment in NYC, probably using their regular law firm(s), no matter where any given guarantor happens to be located.

   - On the other hand, if a particular guarantor had enough bargaining power, it might insist that it could be sued under the guaranty only in a particular jurisdiction, e.g., the guarantor's own home jurisdiction.

See generally, e.g., Anthony R. McClure, There's No Place Like Home—To Establish Personal Jurisdiction (AmBar.org 2018), archived at https://perma.cc/6UJM-HSG6.

4. *Will there be a cap on any guarantor's liability?* (Of course, a guaranty obligation is limited by the amount of the underlying debt, plus any other charges such as enforcement expenses.)

5. *If the underlying obligation is modified, what happens to the guaranty?* The law generally says that modification of the underlying obligation dissolves the guaranty; so too does this Clause (at [NONE]). Guaranty documents sometimes provide otherwise, however.

6. *Must guarantors certify, or update, their financial statements? Must those financial statements be audited?* [NONE] and Option 22.74.22 address the first question; Option 22.74.24 provides option language to address the second.

7. *Can guarantors assert defenses to the underlying debt?* this Clause implicitly says "yes" because Option 22.74.20 allows drafters to say otherwise.

#### *22.74.1.5 Guaranty options*

Creditors sometimes load up guaranty agreement forms with other terms designed to give them an iron grip over the guarantor, as illustrated in some of the provisions of a Bank of America guaranty form at https://tinyurl.com/BAGuaranty (sec.gov).

A few comparatively-unobnoxious examples of such other terms are set out at the end of this Clause.

### 22.74.2 Guarantor's payment obligation

Except as otherwise provided in the Contract, the Guarantor must pay any amount due to the Creditor under the Guaranteed Payment Obligation within five business days after the Creditor asks — in writing — that the Guarantor do so.

*Commentary*

For a "wall of words" guaranty (with a fair amount of language not included here), see a Bank of America guaranty form at https://tinyurl.com/BAGuaranty (sec.gov).

### 22.74.3 Cure-period expiration required

In case of doubt: The Guarantor need not pay an amount due from the Debtor to the Creditor if any relevant cure period for the Debtor's failure to pay has not yet expired.

*Commentary*

A simple example of such a cure period would be a college student's apartment lease, where the student's parent guaranteed that rent would be paid, but the lease also stated that the tenant would not be in breach until three days after the rent due date. Under the above language, the landlord would not be able to demand payment from *the parent* until that three-day period had expired.

### 22.74.4 Guaranty of *payment*, vice of *collection*

IF: The Guaranty does not unambiguously state that it is a guaranty of *collection* (see [NONE]); THEN:

1. the Guaranty is a guaranty of *payment*;

2. the Guarantor's obligation to pay is not affected by the extent, if any, to which the Creditor tried to collect the Guaranteed Payment Obligation from the Debtor before seeking payment from the Guarantor; and

3. the Guarantor WAIVES (see the definition in Clause 22.162) any requirement that the Creditor make any attempt at such collection.

*Commentary*

Under a guaranty of *collection*, a creditor must first exhaust its efforts to collect the amount due from the debtor; thus, the guarantor need pay the creditor only if the creditor obtains a court judgment against the debtor but is unable to collect on the judgment (e.g., because the debtor is broke or judgment-proof). It's useful to make that explicit for the benefit of future readers.

Creditors, though, will typically object to getting a guaranty only of *collection*, because they normally want to be able to go after guarantors immediately to get their money, as opposed to incurring the delay, burden, expense, and uncertainty of first having to file suit against their debtors.

*Note:* In jurisdictions such as Texas, a guarantor of *payment* would have the right to demand that the creditor — "without delay" — file a lawsuit against the debtor, absent which the guarantor is not liable for the guaranteed payment obligation; but subdivisions 2 and 3 putatively waive this right.

See Tex. Civ. Prac. & Rem. Code § 43.002.

See also the following section for the rule for guaranties of *collection*.

### 22.74.5 If a guaranty of *collection*

IF: The Guaranty is unambiguously one of *collection* and not of payment;

THEN: the Creditor will not request payment from any Guarantor,

nor will the Creditor seek to enforce the Guaranty against any Guarantor,

until both of the following are true:

1. the Creditor has obtained, in a court or other forum of competent jurisdiction,

    a final judgment against the Debtor,

    from which no further appeal is taken or possible,

    where the judgment enforces — in whole or in part — the Guaranteed Payment Obligation; and

2. the Creditor has been unable to collect the judgment from the Debtor, in full,

    after diligently making reasonable efforts to do so.

*Commentary*

See the commentary to [NONE].

### 22.74.6 Reimbursement of collection expenses

The Guarantor must pay, or reimburse the Creditor for, any court costs and other reasonable expenses that the Creditor incurs:

1. in successfully enforcing the Creditor's rights under the Guaranty,

2. and/or in successfully enforcing the Guaranteed Payment Obligation in question against the Debtor,

including but not limited to attorney fees (see the definition in Clause 22.16);

this payment or reimbursement is due immediately upon request from the Creditor.

*Commentary*

Expense-shifting language similar to this was used in the guaranty in a case that reached the Alabama supreme court.

See Eagerton v. Vision Bank, 99 So. 3d 299, 305 (Ala. 2012).

For more-detailed language along these lines, see paragraph 10 of a Bank of America guaranty form at https://tinyurl.com/BAGuaranty (sec.gov).

### 22.74.7 Bankruptcy refunds obligation

a. This section applies if a Creditor refunds some or all of a payment made by the Debtor on the Guaranteed Payment Obligation, either:

1. because of a requirement of bankruptcy law; fraudulent-transfer law; or comparable law, or

2. in settlement of a claim for such a refund.

b. In such a case, the Guarantor will pay, or reimburse the Creditor for,

1. the amount refunded by the Creditor; and

2. the Creditor's attorney fees (see the definition in Clause 22.16) incurred in dealing with the claim for refund, if any;

immediately upon written request from the Creditor.

*Commentary*

For similar language along these lines, see paragraph 7 of a Bank of America guaranty form at https://tinyurl.com/BAGuaranty (sec.gov).

Under U.S. bankruptcy law, a creditor might be forced to refund some or all of any payment made by a debtor that subsequently filed for bankruptcy protection; if that were to happen, then the creditor would normally want to recover that refund from any available guarantor.

*Example:* Suppose that:

- A guarantor guarantees a customer's payment to a supplier;
- The customer pays a supplier's invoice;
- Within the next 90 days, the customer files for protection under the bankruptcy laws.

In that situation, the supplier might be compelled to refund the customer's payment (which is referred to as an "avoidable preference").

See, e.g., Patricia Dzikowski, The Bankruptcy Trustee and Preference Claims (Nolo.com; undated); Kathleen Michon, Pre-Bankruptcy Payments to Creditors: Can the Trustee Get the Money Back? (Nolo.com; undated); see also the guaranty language in Cooperatieve Centrale Raiffeisen-Boerenleenbank, B.A. v. Navarro, 25 N.Y.3d 485, 488, 36 N.E.3d 80, 15 N.Y.S.3d 277 (2015).

To be sure, the supplier would have the right to contest its obligation to refund the customer's payment. But that can be difficult: The supplier would have to successfully jump through some hoops to *prove* that it was entitled to keep the customer's payment.

In any event, as a practical matter many such avoidable-preference cases are resolved by agreement — so in our hypothetical case, the bankrupt customer would likely settle for less than a complete refund of what it paid the supplier, and in return, the supplier would give the customer a *partial* refund so as to avoid the expense and hassle of jumping through the required proof hoops.

That's where the guarantor's commitment would kick in: The guarantor would be on the hook to reimburse the supplier for the supplier's refund to the customer (and probably for the supplier's associated legal expenses as well, if the guaranty says so). "Courts have uniformly held that a payment of a debt that is later set aside as an avoidable preference does not discharge a guarantor of its obligation to repay that debt."

Coles v. Glaser, 2 Cal. App. 5th 384, 389, 205 Cal. Rptr.3d 922 (2016) (cleaned up; extensive citations omitted).

### 22.74.8 Broad scope of Guarantor obligations

For purposes of the Guaranty, unless the Guaranty unambiguously says otherwise, it does not matter:

1. how or when the Guaranteed Payment Obligation in question came into being,

    including, without limitation, by acceleration of an underlying obligation or otherwise;

2. whether the Guaranteed Payment Obligation is direct or indirect, absolute or contingent; nor

3. whether the Debtor's own liability for the Guaranteed Payment Obligation was wholly- or partly discharged —

    under a statute, including but not limited to bankruptcy laws,

    or due to an administrative- or judicial decision.

*Commentary*

The above language is fairly typical.

Concerning bankruptcy laws and guarantees, see the extended commentary at [NONE].

### 22.74.9 Waiver of Creditor acceptance and signature

Unless the Guaranty unambiguously says otherwise, it does not matter:

1. whether the Creditor accepted and/or signed the Guaranty; nor

2. whether the Guarantor was notified that the Creditor did accept the Guaranty.

*Commentary*

Creditors commonly don't countersign guaranties, but an aggressive counsel for a guarantor might try to argue that the guaranty (supposedly) cannot be binding on the guarantor if the creditor didn't countersign, so it can't hurt to be explicit.

(The above language likely duplicates applicable law.)

see, e.g., US Bank Nat'l Ass'n v. Polyphase Elec. Co., No. 10-4881 (D. Minn. Apr. 23, 2012), where the court granted summary judgment that a bank could enforce loan guaranties even though *the bank* had not countersigned the guaranties.

### 22.74.10 Guarantor certification of its financial information

Each Guarantor,

by providing any Creditor — at any time — with credit-related information for that Guarantor in connection with the Guaranty,

thereby represents (see the definition in Clause 22.134) and warrants (see the definition in Clause 22.163) to *each* Creditor,

that such information is complete, up to date, and accurate,

in all material respects (see the definition of *material* in [NONE]),

except to the extent, if any, that the Guarantor has unambiguously disclosed otherwise, in writing, to the Creditor first mentioned above.

*Commentary*

See the commentary to Option 22.74.22 and Option 22.74.24.

### 22.74.11 No double-dipping by Creditor

A Creditor:

1. must not knowingly retain duplicate payments, of the same amount due, from multiple Guarantors and/or the Debtor; and

2. must promptly refund any such duplicate payment that it does receive.

*Commentary*

This likely seems obvious, but it can't hurt to have the rule in black and white.

### 22.74.12 Consideration for Guaranty

Each Guarantor agrees to its obligations under the Guaranty in consideration of the Creditor's entry into the Guaranteed Agreement.

*Commentary*

Every first-year law student learns that in the U.S. and similar jurisdictions, a contract ordinarily requires "consideration" to be binding. It's not common for courts to hold that a guaranty is invalid for lack of consideration, but it does happen sometimes.

*Example:* In a Massachusetts case, a company's bookkeeper signed an order for ad space in a Yellow Pages phone book. (Remember those?) Unhappily for the bookkeeper, she didn't read the fine print, which contained a statement that she personally guaranteed payment. A court held that she was not liable on the guaranty because *she* had received no consideration for it — although the result would have been different, the court said, had the bookkeeper been an owner, investor, or principal who signed the order.

See Yellow Book, Inc. v. Tocci, 2014 Mass. App. Div. 20, 22-23 (2014), discussed in Robert W. Stetson, Four Tips for Drafting Enforceable Personal Guarantees, in (BNA) Corporate Counsel Weekly Newsletter, Apr. 9, 2014 (archived at https://perma.cc/4TWZ-FM5X), which includes numerous additional case citations.

### 22.74.13 Guarantors' joint and several liability

IF: Multiple Guarantors guarantee the same Guaranteed Payment Obligation;

THEN: Each Guarantor is jointly and severally liable for all Guarantors' obligations under the Guaranty unless clearly agreed otherwise in writing.

*Commentary*

Creditors generally want multiple guarantors to have "joint and several liability." This means, basically, that any one of of the multiple guarantors might have to pay as much as the entire total of the payment obligation, if the others don't come up with their shares.

See, e.g., the preamble of a Bank of America guaranty form at https://tinyurl.com/BAGuaranty (sec.gov).

**Pro tip:** If multiple guarantors will be guaranteeing *multiple* payment obligations, it's a really good idea for each guaranty to be clear about the extent to which guarantors are liable for which obligations. As a hypothetical example, suppose there's a transaction in which four college students want to rent a four-bedroom apartment, and the landlord wants the students' parents to guarantee payment of the rent. Any given parent likely would want to guarantee payment of rent for the bedroom of that parent's child only and not for any of the other students' bedrooms. (Author's note: My now-adult daughter lived in just such an arrangement while in college; I guaranteed *her* rent, but not that of her flatmates.)

### 22.74.14 Multiple Guarantors' share-alike obligation

a. This section applies if Guarantors A and B guarantee the same Guaranteed Payment Obligation.

b. IF: Guarantor A pays some or all of Guarantor B's share of an amount due under the Guaranteed Payment Obligation because Guarantor B failed to timely pay its share,

THEN: Guarantor B must reimburse Guarantor A for that payment,

plus interest on that payment at the highest rate allowed by law, beginning on the date of that payment (or such later date as is required by law) and continuing on unpaid amounts until paid in full.

*Commentary*

It's good to make clear that any guarantor that fails to come up with that guarantor's share will be liable to any other guarantors that, under [NONE], are forced to pick up the slack.

### 22.74.15 No cap on Guarantor liability

The amount the Guarantor might have to pay under the Guaranty could be as high as the entire, aggregate amount due under the Guaranty.

*Commentary*

In some transactions, a cap on one or more guarantors' liability might be a possible negotiation point (in which case drafters would presumably go into more detail about the cap), perhaps using language such as the following:

> The Guarantors, together, will not be liable for more than [FILL IN AMOUNT], in total, for all Guaranteed Payment Obligations combined.

### 22.74.16 No Guarantor reliance on Creditor investigation

The Guarantor:

1. certifies that it has not relied, and is not relying, on the Creditor, nor on any Creditor affiliate (see the definition in Clause 22.2), for information about the Debtor's ability or willingness to pay the Guaranteed Payment Obligation when due; and

2. WAIVES (see the definition in Clause 22.162) any duty that the Creditor (or any Creditor affiliate) might have to disclose such information to the Guarantor (or any Guarantor affiliate).

*Commentary*

For an example of similar language, see paragraph 12 of a Bank of America guaranty form at https://tinyurl.com/BAGuaranty (sec.gov) signed in 2009 by Heald Capital, LLC. Such a provision should help to forestall arguments by creative guarantor counsel that the creditor had some sort of duty to disclose adverse information about the debtor.

### 22.74.17 Enforcement rights of Creditors' successors

The successors and assigns of any Creditor in respect of the Guaranteed Payment Obligation may enforce the Guaranty.

*Commentary*

The above language makes it clear that any creditor's successors may also enforce the guaranty. That's because loans are often packaged and sold to different parties ("successors and assigns") that collect payments (which are sometimes "sliced and diced" in the process), and guaranties are often part of the "collateral" in the loan package — any of the original lender's successors and assigns will therefore want to be able to enforce a guaranty as part of their "collateral" for the loan.

For similar language along these lines, see paragraph 16(b) of a Bank of America guaranty form at https://tinyurl.com/BAGuaranty (sec.gov).

### 22.74.18 Dissolution of Guaranty by modification

The Guaranty will be void if the Guaranteed Payment Obligation is modified in any material respect unless the Guarantor consented in writing to the modification.

*Commentary*

The general rule — which typically is strictly applied by courts — is that "a guarantor is discharged if, without his or her consent, the contract of guaranty is materially altered." The above language in essence restates that rule.

See generally, e.g., Eagerton v. Vision Bank, 99 So. 3d 299, 305-06 (Ala. 2012) (modification of loan discharged guarantors from further obligations) (cleaned up; citations omitted); *accord*, Sterling Development Group Three, LLC, v. Carlson, 2015 N.D. 39 (guaranty was discharged by alteration of guaranteed obligations without guarantor's knowledge or consent) (citing state statute).

Alternative:

> An amendment to or modification of a Guaranteed Payment Obligation does not discharge or otherwise affect Guarantor's obligation under the Guaranty for that Guaranteed Payment Obligation

For examples of language like this, see, e.g., paragraph 1 of a Bank of America guaranty form at https://tinyurl.com/BAGuaranty (sec.gov); Cooperatieve Centrale Raiffeisen-Boerenleenbank, B.A. v. Navarro, 25 N.Y.3d 485, 488, 36 N.E.3d 80, 15 N.Y.S.3d 277 (2015).

### 22.74.19 Governing law for Guaranty

Unless the Guaranty unambiguously provides otherwise, the Guaranty is to be interpreted and enforced, and any dispute arising out of or relating to the Guaranty is to be decided, under the law of the state of New York as applied to contracts made and performed entirely in that state by residents of that state.

*Commentary*

In a complex- or sophisticated transaction, a guaranty document might provide that, say, New York law governs the guaranty, even if some other state's law governs the rest of the transaction — or vice versa.

Cf. Kronovet v. Lipchin, 288 Md. 30, 415 A.2d 1096 (1980), in which loan documents for a real-estate project adopted local Maryland law for interest- and usury issues but New York law for others, *cited in* Restatement (Second) of Conflicts of Laws, comment i to § 187 (1988 update). This section likewise specifies New York law as a gap-filler to forestall ancillary disputes about which law applies.

On the other hand, paragraph 16 of a Bank of America guaranty form at https://tinyurl.com/BAGuaranty (sec.gov) provides that California law will apply.

### 22.74.20 Option: Guarantor Waiver of Defenses

a. *Applicability:* This Option applies only if the Contract umambiguously says so.

b. *Absolute obligations:* The Guarantor acknowledges (see the definition in Clause 22.1) that the Guarantor's obligations under the Guaranty are absolute, unconditional, direct and primary.

c. *WAIVER:* The Guarantor WAIVES (see the definition in Clause 22.162):

1. any claim or defense that those obligations under the Guaranty are allegedly illegal, invalid, void, or otherwise unenforceable;

2. any claim or defense that the Guarantor might have pertaining to any part of the Guaranteed Payment Obligation, other than the defense of discharge by full performance;

this includes, without limitation,

any defense of waiver, release, statute of limitations, res judicata, statute of frauds, fraud, incapacity, minority, usury, illegality, invalidity, voidness, or other unenforceability

that might be available to the Debtor or any other person who might be liable in respect of any Guaranteed Payment Obligation;

3. any setoff available to the Debtor or any other such person liable, whether or not on account of a related transaction;

4. all rights and defenses arising out of an election of remedies by a Creditor,

such as, for example (see the definition in Clause 22.59), a nonjudicial foreclosure with respect to security for a Guaranteed Payment Obligation,

even if that election of remedies resulted, or could result,

in impairment or destruction of the Guarantor's right of subrogation and/or reimbursement against *the Debtor*; and

5. any other circumstance that might otherwise absolve the Guarantor of any obligation under the Guaranty.

*Commentary*

A creditor with bargaining power might well want a guarantor to commit to pay a debt even if the debtor could escape liability for the debt by asserting one or more available defenses. The creditor might use language such as that of this Option.

Subdivision a: The "absolute, unconditional" language in subdivision a makes for a pretty-strong guaranty — at least in some jurisdictions, such a guaranty is likely to be enforced even in what might seem like unfair circumstances, such as collusion between the Creditor and the Debtor.

> For an example of guaranty enforcement under seemingly-unfair circumstances, see the decision by the Court of Appeals of New York (which is that state's highest court). See Cooperatieve Centrale Raiffeisen-Boerenleenbank, B.A. v. Navarro, 25 N.Y.3d 485, 36 N.E.3d 80, 15 N.Y.S.3d 277 (2015).

On the other hand, a court held that liquidated-damages provisions in aircraft leases were unenforceable penalties and thus — as a matter of public policy — could not be enforced against the leases' guarantors any more than against the debtors:

> > Given the weight of authority, this Court concludes that the Guarantees here are not enforceable for the same reason as the underlying obligations: the liquidated damages clauses in the Amended Leases violate public policy. Such a conclusion is consistent with case law from this Circuit holding that, as a matter of public policy, parties may not waive defenses to liquidated damages clauses.
>
> In re Republic Airways Holdings Inc., 598 B.R. 118, 147 (Bankr. S.D.N.Y. 2019) (citing numerous cases).

Subdivision b: The use of all-caps type for WAIVES is for conspicuousness; see generally the discussion at § 11.4.

Some of the items listed in subdivision b are based on those of the respective guaranties in two litigated cases.

> Cooperatieve Centrale Raiffeisen-Boerenleenbank, B.A. v. Navarro, 25 N.Y.3d 485, 488, 36 N.E.3d 80, 15 N.Y.S.3d 277 (2015); Eagerton v. Vision Bank, 99 So. 3d 299, 309 (Ala. 2012).

Subdivision b.3: In guaranties, "setoff" language like this is not uncommon; see, e.g., paragraphs 2 and 4 of a Bank of America guaranty form at https://tinyurl.com/BAGuaranty (sec.gov).

> See also the guaranty language in Moayedi v. Interstate 35/Chisam Road, LP, 438 S.W.3d 1, 3 (Tex. 2014) (affirming that guarantor's waiver of defenses negated statutory right of offset).

Subdivision c: This waiver-of-defenses language is in part adapted from California Civil Code § 2856(c) and (d); see also, for example, paragraphs 1, 4, and 18 of a Bank of America guaranty form at https://tinyurl.com/BAGuaranty (sec.gov).

### 22.74.21 Option: Agreed Forum for Guaranty Enforcement

a. *Applicability:* This Option applies only if the Contract umambiguously says so.

b. *Forum:* Any Creditor may sue any Guarantor to enforce the Guaranty in respect of that Creditor's rights under the Guaranteed Payment Obligation,

> in the state- and federal courts having jurisdiction in the Borough of Manhattan, New York, New York, USA
>
> or any other forum unambiguously specified in the Guaranty,
>
> without regard to where the Guarantor happens to be domiciled or otherwise located.

c. *No agreement to* general *jurisdiction:* In case of doubt, when a Guarantor agrees to a particular forum under subdivision b, that does *not* mean that the Guarantor is submiting to the general jurisdiction of that forum.

*Commentary*

See the discussion of this subject in the drafter checklist of the commentary at [NONE].

### 22.74.22 Option: Updated Financial Statements from Guarantors

a. *Applicability:* This Option applies only if the Contract umambiguously says so.

b. No later than 45 days after the end of each calendar quarter, the Guarantor will provide the Creditor with a copy of the Guarantor's financial statement for that period (each, an "updated financial statement").

c. The Guarantor will be deemed to have certified the accuracy of each updated financial statement as stated in [NONE],

*Commentary*

Tango Clause 22.74.10 - Guarantor certification of its financial information contains a guarantor certification of any financial statements it provided to the creditor. Taking that notion further: A creditor might want a guarantor to periodically provide updated financial statements to give the creditor at least some ongoing comfort that guarantor continues to have the wherewithal to back up the guaranty commitments, possibly using language such as that of this Option.

**Pro tip:** Drafters should consider what "Plan B" provisions to include in a guaranty in case a guarantor's financial position were to slip below acceptable levels. [TO DO: Research Plan B provisions]

See also Option 22.74.23

### 22.74.23 Option: SEC Standards for Guarantor Financial Statements

a. *Applicability:* This Option applies only if the Contract umambiguously says so.

b. *Standards:* The Guarantor will ensure that each set of financial statements that the Guarantor provides to the Creditor is prepared in accordance with the disclosure requirements applicable to guarantors of guaranteed debt under the U.S. securities laws.

*Commentary*

A creditor might want guarantors to provide financial statements that conform to particular standards, such as those that apply to public offerings of guaranteed debt.

See generally, e.g., Michael H. Friedman, Public Offerings of Guaranteed Debt and the SEC's Proposed Rule Changes (PepperLaw.com 2018), which discusses Rule 3-10(a)(1) of Regulation S-X.

(A creditor might want to specify other financial standards that must be met.)

### 22.74.24 Option: Audits of Guarantor Financial Statements

a. *Applicability:* This Option applies only if the Contract umambiguously says so.

b. *Audit & review requirements:* The Guarantor must ensure that the *year-end* financial statements that the Guarantor provides to the Creditor are *audited*,

and that such *quarterly* financial statements are *reviewed*,

by an independent public accounting firm.

c. *Copies of reports:* For each audit and each review, the Guarantor will cause the public accounting firm to promptly provide the Creditor with a complete and accurate copy of the accounting firm's report.

*Commentary*

A creditor might want to require a guarantor to provide copies of audit reports of its financial statements. Some guarantors might object to being asked to incur that extra accounting expense — but that expense should be minimal if the guarantor's financial statements would be audited and reviewed anyway (for example, if the guarantor was a public company):

Subdivision b requires the accounting firm, not the guarantor, to provide copies of the firm's reports; this reduces the risk of forgery or alteration by the guarantor.

## Clause 22.75 Hold Harmless Definition

*Hold harmless* has the same meaning as *indemnify.*

*Commentary*

The above definition reflects what seems to be a consensus by legal writing experts. Some courts have held otherwise — treating *hold harmless* as amounting to an advance waiver, release, or exculpation, of stated claims against the person held harmless — but famed lexicographer Bryan Garner marshals an impressive body of evidence that *indemnify* and *hold harmless* should be treated as synonyms, asserting that the former is Latinate in origin, while the latter is the English counterpart. (This, even though courts ordinarily construe contracts so as to give effect to each provision.)

See Bryan A. Garner, *Garner's Dictionary of Legal Usage*, at 443-45 (2011), *excerpt available at* http://goo.gl/LdVxN; Bryan A. Garner, indemnify *[sic]*, 15 Green Bag 2d 17 (2011), archived at http://perma.cc/4VBV-FDJS.

## Clause 22.76 If Definition

The term *if*, when used in granting a right or imposing an obligation that would not otherwise apply, means *if and only if* unless the context clearly indicates otherwise.

*Commentary*

This definition might seem to be overkill — but consider a Seventh Circuit case: The principal owner of a cardboard-box manufacturer entered into a letter of intent (LOI) to sell the company. The LOI stated that: "**IF** the Seller … provides to Customer written notice that negotiations toward a definitive asset purchase agreement are terminated, **THEN** Seller shall pay Customer a breakup fee of two hundred thousand dollars ($200,000)." The seller never did provide written notice of termination, as stated in the breakup-fee obligation — but the buyer claimed that the seller was obligated to pay the breakup fee anyway.

> See Trovare Capital Group, LLC v. Simkins Indus., Inc., 646 F.3d 994, 996 n.1 (7th Cir. 2011) (reversing and remanding summary judgment; emphasis and all-caps added); *after remand*, 794 F.3d 772 (7th Cir. 2015).

In that case, the above definition of *if* might have helped establish that the seller was *not* required to pay the breakup fee unless it sent the buyer a written notice of termination before the sunset date. *Postscript:* On remand, the trial court found that the seller did not have to pay the breakup fee; the appeals court affirmed.

An English case reached a *somewhat*-contrary result: Under a real estate seller's contract with an agent, the agent was entitled to a "success fee" if the property was sold for a stated price — but the sale was for a lower price. The court of appeal held that in context, the term *if* did not mean *if and only if*, and so the agent was awarded a (reduced) success fee under an unjust-enrichment theory — even though normally unjust enrichment is not available when the parties have a contract — on grounds that the parties' agreement did not address what would happen if the sale was at a lower price, and so recovery for unjust enrichment was not precluded.

> See Barton v. Gwyn-Jones, [2019] EWCA Civ 1999 ¶¶ 31-34.

## Clause 22.77 Including Definition

a. The term *including* is not to be taken as limiting; instead, the term is to be read as though it had been written as, *including but not limited to*,

unless the context clearly indicates otherwise.

The same is true for like terms such as *include*, *includes*, and *included*.

(In legalese: The parties do not wish for the principle of *ejusdem generis* to call for a different result.)

b. In some places a document might use expressions such as *including but not limited to* or *including without limitation*.

If that is the case, it does not mean that the parties intended for *shorter* expressions — such as, simply, *including*, by itself — to serve as limitations,

unless the document expressly states otherwise.

(In legalese: The parties do not wish for the principle of *expressio unius est exclusio alterius* to call for a different result.)

*Commentary*

This definition eliminates (or at least reduces) the need to repeatedly write (and read), for example, "including without limitation." It's not uncommon in contracts, and generally uncontroversial.

For a bit of controversy, though: See Kenneth A. Adams, An Update on "Including But Not Limited To" (AdamsDrafting.com 2015), critiquing Bryan A. Garner, LawProse Lesson #227: Part 2: "Including but not limited to" (LawProse.org 2015).

Subdivision a – *ejusdem generis*: As the Third Circuit pointed out: "By using the phrase 'including, but not limited to,' the parties unambiguously stated that the list was not exhaustive. … [S]ince the phrase 'including, but not limited to' plainly expresses a contrary intent, the doctrine of *ejusdem generis* is inapplicable."

Cooper Distributing Co. v. Amana Refrigeration, Inc., 63 F.3d 262, 280 (3d Cir. 1995) (Alito, J.) (citations omitted); to like effect is Eastern Air Lines, Inc. v. McDonnell Douglas Corp., 532 F.2d 957, 988-89 (5th Cir. 1976). *See also* Robert E. Scott and George G. Triantis, Anticipating Litigation in Contract Design, 115 Yale L.J. 814 (2006): "Contracting parties can avoid a restrictive interpretation under the *ejusdem generis* rule by providing that the general language includes but is not limited to the precise enumerated items that either precede or follow it." *Id.* at 850 & n.100, *citing Cooper Distributing and Eastern Airlines*.

Subdivision b — *expressio unius, etc.:* See generally *expressio unius est exclusio alterius*, Black's Law Dictionary (10th ed. 2014)

# Clause 22.78 Indemnities Protocol

## 22.78.1 Applicability

This Clause applies if and when, under the Contract, a party must indemnify another party.

*Commentary*

A contractual right to be indemnified — i.e., to be reimbursed — can have serious financial implications.

Consider a Nebraska case: In a ConAgra food plant, an explosion killed three people and injured 60 more people injured. The explosion was caused by human error during installation of a new industrial water heater. Lawsuits were filed against, among others, a contractor, Jacobs Engineering, that was peripherally involved in the installation project *but was not involved in, nor was it responsible for supervising*, the specific actions by an employee of *another* contractor that led to the explosion.

(Editorial comment, with apologies to Jane Austen: It is a truth universally acknowledged, that anyone in possession of a good fortune — their own, or in an insurance policy — might be sued by plaintiffs' lawyers if there exists even the most tenuous connection to a cause of action.)

The contract between Jacobs Engineering and ConAgra required ConAgra to indemnify Jacobs Engineering in certain circumstances; Jacobs sought indemnification, but ConAgra refused. Only one of the lawsuits against Jacobs made it as far as going to to trial. Jacobs had moved for summary judgment in that case, but the motion was denied. Not wanting to risk an adverse jury verdict, Jacobs settled with the plaintiffs in that lawsuit — and then Jacobs sued ConAgra for reimbursement under the contract's indemnification provision.

In a trial of Jacobs Engineering's indemnification claim against ConAgra, the jury awarded Jacobs the full amount of what Jacobs had paid to settle the underlying claims, totalling **$108.9 million**. The state supreme court affirmed judgment on the jury verdict.

> See Jacobs Eng'g Group Inc. v. ConAgra Foods, Inc., 301 Neb. 28, 917 N.W. 2d 435, 444 (2018).

Indemnity- and defense obligations in contracts can become especially important if a catastrophic event occurs, such as an oil-well blowout — and if the relevant contract has been *assigned*, things can get even more … interesting.

> See, e.g., the contract diagram in Certain Underwriters at Lloyd's, London v. Axon Pressure Prods. Inc., 951 F.3d 248 (5th Cir. 2020), in the aftermath of an oil-well blowout in the Gulf

of Mexico.

### 22.78.2 Definitions: *Indemnify*; *hold harmless*; *Event*

The verb *indemnify*, and its synonym *hold harmless*, relate to losses and/or expenses resulting from one or more specified categories of event, each referred to as an "*Event*."

*Commentary*

This definition reflects what seems to be a consensus by legal-writing experts: The term *hold harmless* is the second part of the doublet *indemnify and hold harmless*. "The evidence is overwhelming that *indemnify* and *hold harmless* are perfectly synonymous. The first is Latinate, the second Anglo-Saxon. And it would be possible to multiply 20th- and 21st-century authorities to this effect."

Bryan A. Garner, indemnify *[sic]*, 15 Green Bag 2d 17, 21 (2011), archived at http://perma.cc/4VBV-FDJS; see also Bryan A. Garner, *Garner's Dictionary of Legal Usage* 443-45 (2011), http://goo.gl/LdVxN.

### 22.78.3 Indemnity obligations as strict-liability terms

a. IF: A party ("*Payer*") is required, by the Contract or by law to indemnify another party ("*Beneficiary*") upon the occurrence of an Event;

> THEN: If the Event were to occur, Payer must promptly pay, or reimburse Beneficiary for, any foreseeable loss or expense that Beneficiary incurs as a result of the Event,
>
> upon written request from Beneficiary,
>
> unless the Contract clearly provides otherwise.

b. In case of doubt, Beneficiary need not prove that Payer was negligent, or otherwise at fault, to be entitled to have Payer pay for Beneficiary's losses and/or expenses from the Event,

> unless the indemnity obligation itself, by its clear terms, extends only to Payer's negligence or other fault.

*Commentary*

For citations of cases holding that a Beneficiary need not prove that the indemnifying party was liable, see the Montana supreme court's opinion in A.M. Welles, Inc. v.

Montana Materials, Inc., 2015 MT 38, 378 Mont. 173, 342 P.3d 987, 989, ¶¶ 10-11 (2015) (reversing denial of summary judgment in favor of reimbursed party).

### 22.78.4 Indemnity obligation includes claim defense

IF: The Contract requires Defender to indemnify Beneficiary for losses and expenses resulting from specified third-party claims;

BUT: The Contract is silent about whether Defender must *defend* Beneficiary against such claims;

THEN: Defender must provide Beneficiary with a defense against any such claim as provided in Tango Clause 22.46 - Defense of Third-Party Claims.

*Commentary*

If a contract requires A to *indemnify* B against a third-party claim, then the law, especially in California, might require A also to *defend* B against the claim — even if the agreement didn't expressly include such a requirement.

> See, e.g., Cal. Civ. Code 2778(3); Crawford v. Weather Shield Mfg. Inc., 44 Cal. 4th 541, 553 (2008).

But A's duty to defend B might not apply if A "can conclusively show by undisputed facts that plaintiff's action is not covered by the agreement."

> Centex Homes v. R-Help Constr. Co., 32 Cal. App. 5th 1230, 1237 (2019), *citing* Montrose Chemical Corp. v. Superior Court, 6 Cal. 4th 289, 298, 861 P.2d 1153 (1993).

On the other hand, as Dentons partner Stafford Matthews pointed out in a 2014 LinkedIn discussion thread (membership required): "Under the common law of most states, including New York and Illinois for example, *an indemnitor generally has no duty to defend unless* the contract specifically requires such defense."

> Emphasis added; Mr. Matthews was responding to one of the present author's comments, and cited Bellefleur v. Newark Beth Israel Med. Ctr., 66 A.D.3d 807, 809 (N.Y. App. Div. 2d Dep't 2009); CSX Transp. v. Chicago & N. W. Transp. Co., 62 F.3d 185, 191-192 (7th Cir. 1995).

### 22.78.5 Indemnity insurance required?

It is up to Payer's sole discretion (see the definition in Clause 22.49) to decide whether to carry insurance to cover Payer's indemnity obligation(s) under the Contract unless the Contract clearly specifies otherwise.

*Commentary*

**Pro tip:** *Any* time that you're drafting an obligation for another party to indemnify your client, consider whether to include a requirement that the indemnifying party must obtain insurance to cover the indemnity obligation — otherwise, if and when the time comes, the indemnifying party might not have the financial wherewithal to comply with its indemnity obligation.

Author's note: I tell my students to remember the initialism "I and I" (eye and eye), for *Indemnification and Insurance*. (American military veterans will recognize the initialism as also being used for a different meaning ….)

### 22.78.6 Prompt indemnity payment required

a. Payer must pay or reimburse Beneficiary for covered losses and expenses as stated in this section.

b. IF: Beneficiary has not already paid for a covered loss or expense itself;

THEN: Payer must reimburse Beneficiary for the loss, or pay the expense,

promptly after Beneficiary presents Payer with a written request for payment or reimbursement.

c. IF: Beneficiary has already paid for a covered loss or expense itself;

THEN: Payer must reimburse Beneficiary for the payment in the same manner as stated in subdivision b.

d. Under either of subdivisions b and/or c, Payer may require Beneficiary to provide Payer with reasonable supporting evidence of the loss or expense.

### 22.78.7 No coverage of Beneficiary's own indemnity obligations

In case of doubt, Payer need not indemnify Beneficiary against any claim, loss, or expense if the same arises only because Beneficiary is contractually obligated to indemnify and/or defend a third party.

*Commentary*

This section is inspired by the contract in suit in a Fifth Circuit case.

Certain Underwriters at Lloyd's, London v. Axon Pressure Prods. Inc., 951 F.3d 248, 261, 265 (5th Cir. 2020) (affirming summary judgment in relevant part).

### 22.78.8 Coverage of Beneficiary's "consequential damages"?

Payer need not indemnify the Beneficiary for consequential damages (see the definition in Clause 22.35) arising from or relating to the Event unless the Contract expressly specifies otherwise.

*Commentary*

This exclusion is designed to avoid positioning a reimbursing party as an insurer for another party's *unusual* losses, etc., unless the parties have affirmatively specified otherwise.

By way of background, in Anglo-American jurisprudence:

- Damages for breach of contract are generally limited to those that are not only foreseeable, but within the contemplation of *both* parties as possibly occurring within the usual course.

  See generally the definition of *consequential damages* and its commentary.

- If a party A breaches a contract and causes B to incur damages, B generally must make reasonable effort to mitigate the damages.

But liability *for indemnity* might not be subject to such limitations, nor to a duty to mitigate (although the case law is unclear on this point).

See generally Glenn D. West, Consequential Damages Redux …, 70 Bus. Lawyer 971, 975 (Weil.com 2015) ("III. A Basic Primer on Contract Damages"), archived at https://perma.cc/D2HC-Z5XD; *id.* at 998-99: "[I]t bears repeating that there is, in fact, a very clear distinction (whether or not there is an ultimate difference) between a claim for indemnification and a claim for damages for breach of a representation and warranty in an acquisition agreement."

### 22.78.9 No coverage of reasonably-avoidable damages

Payer will not be liable for indemnity to Beneficiary to the extent that Beneficiary could have avoided (or mitigated) the damages by commercially-reasonable efforts (see the definition in Clause 22.32).

*Commentary*

The intent of this exclusion is to avoid creating moral hazard by giving Beneficiary an incentive to take reasonable steps to reduce its damages.

### 22.78.10 "Express Negligence Rule" applies

Payer need not indemnify Beneficiary for losses and/or expenses that result from the Beneficiary's own negligence or gross negligence, unless:

1. the Contract *expressly* and *conspicuously* so states; and
2. applicable law does not prohibit that kind of indemnity obligation.

*Commentary*

This exclusion adopts the express-negligence doctrine that applies in some states such as California and Texas.

See, e.g., Crawford v. Weather Shield Mfg. Inc., 44 Cal. 4th 541, 552 (2008); Dresser Industries v. Page Petroleum, Inc., 853 S.W.2d 505, 508 (Tex. 1993) (conspicuousness requirement); Ethyl Corp. v. Daniel Constr. Co., 725 S.W.2d 705, 708 (Tex. 1987) (express-negligence doctrine). See generally, e.g., Byron F. Egan, Indemnification in M&A Transactions for Strict Liability or Indemnitee Negligence: The Express Negligence Doctrine (JW.com 2014), archived at http://perma.cc/RS63-FWKE.

**Caution:** In some places, an indemnity obligation (other than in an insurance policy) might be unenforceable to the extent it purports to protect a party from its own negligence.

See, e.g., Ashley II of Charleston, L.L.C. v. PCS Nitrogen, Inc., 409 S.C. 487, 490-92, 763 S.E.2d 19 (S.C. 2014).

See also the commentary on conspicuousness in Section 11.4: .

NOTE: In Texas, *advance* releases of negligent conduct must also be both express and conspicuous: "[W]e hold that the fair notice requirements of conspicuousness and the express negligence doctrine apply to both indemnity agreements *and to releases* in the circumstances before us …."

Dresser Industries v. Page Petroleum, Inc., 853 S.W.2d 505 (Tex. 1993) (emphasis added).

### 22.78.11 No coverage of Beneficiary's willful misconduct

Payer need not indemnify Beneficiary for losses or expenses that result from willful misconduct (see the definition in Clause 22.166) by Beneficiary

*Commentary*

This exclusion would probably be the law in most U.S. jurisdictions, on the basis that allowing a party to shuck off liability for its own willful misconduct would create moral hazard and be against public policy.

### 22.78.12 Cap on indemnity liability?

a. Payer's liability to Beneficiary for indemnifiable losses and expenses resulting from an Event is not limited unless the Contract clearly states otherwise.

b. A general damages cap in the Contract does not count for purposes of subdivision a,

unless that cap expressly limits liability for indemnity specifically.

*Commentary*

Prospective beneficiaries of indemnity obligations often want language like this.

### 22.78.13 "First-party" claims covered?

Payer's indemnity obligations to Beneficiary are not limited to *third-party* claims against Beneficiary,

but instead extend as well to Beneficiary's own claims against Payer,

unless the particular indemnity- or defense language clearly specifies otherwise.

*Commentary*

This section is intended to "write around" a split in the case law as to whether an indemnity obligation must be "unmistakably clear" that it *does* or does *not* cover claims between the parties themselves.

For citations, see the briefs in an unsuccessful petition to the Texas supreme court in Claybar v. Samson Exploration LLC, No. 09-16-00435-CV (Tex. App.—Beaumont 2018, pet. denied): Appellant's brief: https://tinyurl.com/ClaybarSamsonAppellantBrief; Respondent's Brief: https://tinyurl.com/ClaybarSamsonRespBrief.

### 22.78.14 Option: "Sunset" on indemnity obligations

a. This Option applies only if the Contract umambiguously says so.

b. Payer need not indemnify Beneficiary in response to any notice of request for indemnity that is received or refused by Payer on or after three years after the effective date (see the definition in Clause 22.53) of the Contract.

*Commentary*

Drafters for prospective indemnity beneficiaries should think carefully before agreeing to this Option. That's especially true for indemnities concerning situations that might not come to light for years, such as claims arising from unseen pollution and other environmental problems.

See, e.g., Laurence S. Kirsch and Nathan J. Brodeur, Structuring Corporate and Real Estate Transactions to Minimize Environmental Risk, 60 Conf. Consumer Fin. L. Qtrly Rep. 179, 191 (2006)

.

This Option provides for a three-year sunset; authors from a Texas BigLaw firm note that in loan documents:

> A typical sunset provision will state that borrower's indemnification obligations under the environmental indemnity agreement will terminate "x" number of years after the full repayment of the loan in accordance with the terms of the loan documents. The duration of time is subject to negotiation, but the typical duration is between one and five years after the full repayment of the loan.

Jeff Civins, Mary Mendoza, and Greg Salton, Identifying and Indemnifying Against Environmental Risks, at 18 (2015). A sunset provision might also require the indemnifying party to obtain a final "clean bill of health" inspection or assessment report and provide it to the beneficiary. *See id*. at 21.

## Clause 22.79 Independent Contractors

### 22.79.1 Party intent: Nature of relationship

Each party is entering into the Contract with the intent that all parties will be independent contractors with respect to one another; no party has any intention of entering into (for example), an employment relationship; a joint venture; or a partnership.

*Commentary*

*22.79.1.1 Business context*

Contracts often contain independent-contractor declarations. But as discussed below, a court might give such a declaration little or no weight. (U.S.) Supreme Court precedent makes it clear that "there is no shorthand formula or magic phrase" for independent–contractor status.

See NLRB v. United Insurance Co. of America, 390 U.S. 254 (1968).

Other courts have held that declarations such as those of this subdivision won't necessarily carry the day; for example, in 2014 a three-judge panel of the Ninth Circuit held that under California law, the plaintiffs in a class-action suit, who were drivers for FedEx, were not independent contractors but employees; a concurring opinion noted, somewhat acidly:

> Abraham Lincoln reportedly asked, "If you call a dog's tail a leg, how many legs does a dog have?" His answer was, "Four. Calling a dog's tail a leg does not make it a leg." … FedEx was not entitled to "write around" the principles and mandates of California Labor Law …. The Court of Appeal in *[an earlier]* case appropriately called the trial court's observation an application of the looks like, walks like, swims like, and quacks like a duck test.

See Alexander v. FedEx Ground Package System, Inc., 765 F.3d 981, 984 (9th Cir. 2014); *id.* at 998 (Trott, J., concurring) (citations omitted, edited for readability).

#### *22.79.1.2 IRS guidance about independent-contractor status*

The [U.S.] Internal Revenue Service's Web site offers easy-to-read guidance about what the Service considers in determining whether someone is an employee (for whom the employer must pay certain taxes) or an independent contractor.

#### *22.79.1.3 A California statute defined "employee" status …*

In 2019, the California legislature enacted a statute, known as AB 5, which added a new section 2750.3 (later repealed) to the California Labor Code, setting out a three-part *initial* test for whether someone is an independent contractor instead of an employee. The statute, however — and a subsequent amendment — goes on to set forth carve-outs for certain occupations that are worth a careful review.

See generally, e.g., Jaclyn Gross & Joshua A. Rodine, Something's Afoot in Tinsel Town: New Laws for the Entertainment Industry (Dec. 2019). The list of carve-outs was expanded in a subsequent bill, AB 2257. See Timothy T. Kim, Jonathan Barker and Justine M. Phillips, Expanding Independent Contractors In California: New Law Awaits Governor's Signature (Mondaq.com 2020).

#### *22.79.1.4 … but "Prop 22" overruled that statute for certain "gig" drivers*

Gig-economy companies Uber, Lyft, and others didn't take California's AB 5 lying down: They funded a ballot initiative, Proposition 22, entitled *Exempts App-Based Transportation and Delivery Companies from Providing Employee Benefits to Certain Drivers*, classifying certain app-based drivers as independent contractors; the initiative passed with more than 58% of the vote.

See 2020 California Proposition 22 (Wikipedia.org).

#### *22.79.1.5 Check state- and even city laws and ordinances*

Companies wanting to do business with freelance workers should check whether any state- or local law might apply. For example, beginning in January 2021:

> The Minneapolis Freelance Worker Protections Ordinance requires businesses, and even some individuals, to enter into written agreements with particular requirements with most freelance workers. Companies that breach those agreements can face stiff penalties from the City in addition to breach-of-contract and other statutory damages. Companies, particularly those that are app-based, often design their business plan around an independent contractor model and are especially likely to feel the Ordinance's impact.
>
> Jacqueline E. Kalk and Ben Sandahl, Minneapolis Increases Protections For Freelance Workers (Mondaq.com 2021).

#### *22.79.1.6 John Oliver's "take" on the WWE's position*

In a 2019 episode of HBO's *Last Week Tonight*, John Oliver took on the WWE's position that its wrestlers are independent contractors who must provide their own health insurance, etc. Spoiler alert: Oliver thinks the WWE's position is, in Oliver's own words, "[freaking bovine excrement]."

See https://www.youtube.com/watch?v=m8UQ4O7UiDs A good "closing argument" summarizing the evidence starts at about 8:00 into the clip.

### 22.79.2 No agency relationship intended

No party is authorized to act as an agent for any other party in respect of any matter relating to the Contract.

*Commentary*

As with independent-contractor status, merely *saying* "there's no agency relationship here" won't make it so. In a Seventh Circuit case, "a district judge concluded that DISH Network and its agents committed more than 65 million violations of telemarketing statutes and regulations. The penalty: **$280 million**." In mostly affirming the judgment, the appeals court noted that "[t]he contract *[between DISH and its representatives]* asserts that it does not create an agency relation, but **parties cannot by ukase negate agency** if the relation the contract creates is *substantively* one of agency."

United States v. DISH Network LLC, No. 09-3073, slip op. at 1, 5 (7th Cir. Mar. 26, 2020) (citation omitted, bold-faced emphasis added).

### 22.79.3 No fiduciary relationship intended

In case of doubt: The parties do not intend for the Contract to establish, nor to evidence, a fiduciary relationship between the parties.

*Commentary*

Routine contract disputes can be made more complicated if an aggressive lawyer tries to claim that the lawyer's client was an agent of another party, or that another party owed a fiduciary duty to the client.

See, e.g., Pappas v. Tzolis, 20 N.Y.3d 228 (2012), in which New York's highest court rejected a claim that a defendant was a fiduciary. For that reason, this section explicitly disclaims any intent to form an agency- or fiduciary relationship.

### 22.79.4 Prohibition of certain specific inconsistent actions

No party may purport to do,

nor attempt to do,

any of the following things,

except to the minimum extent (if any) that the Contract clearly states otherwise,

or as otherwise unambiguously agreed in writing:

1. make any promise, representation, or warranty, on behalf of any other party, concerning the subject matter of the Contract;

2. hold itself out as an employee, agent, partner, joint venturer, division, subsidiary, branch, or other representative of another party:

3. hire any individual to be an employee of another party;

4. determine working hours or working conditions of another party's employees;

5. select or assign any employee of another party to perform a task;

6. direct or control the manner in which any employee of another party performs his or her work — as distinct from specifying the

result to be accomplished by that work;

7. remove any employee of another party from a work assignment;

8. discharge or otherwise discipline any employee of another party;

9. incur any debt or liability on behalf of another party;

10. bind another party to any other type of obligation, commitment, or waiver.

*Commentary*

A drafter might want to add the following:

> Each party, upon request by another party, must defend (as defined in Clause 22.46) that other party's Protected Group (as defined in Clause 22.126) against any third-party claim that arises from the first party's alleged noncompliance with this Clause.

## Clause 22.80 Individual Liability Protection

### 22.80.1 Protected individuals

a. The parties intend for this Clause to benefit each of the following "*Protected Individuals*," namely individuals (i.e., people) when serving in any of the following capacities for (i) any party to the Contract (each, a "*Contracting Party*"), and/or (ii) any affiliate (see the definition in Clause 22.2) of any Contracting Party:

1. directors; officers; employees; incorporators;

2. partners; members; managers;

3. stockholders and other investors;

4. agents; attorneys; accountants;

5. representatives; financial advisors; and lenders;

in each case whether past, present, or future,

b. The term *Protected Individual*, however, does not include any individual who is expressly identified in the preamble of the Contract as being a party to the Contract.

*Commentary*

Parties should consider building in some contractual protection for their employees and other personnel — such as that of this Clause — when negotiating contracts that might prove contentious or that could result in claims for big dollars being thrown around. That's because a dissatisfied party to a contract might sue not only the other party, but the other party's employees, etc. This might occur, for example:

- if the plaintiff felt that the defendant company had too-few assets that could be seized to satisfy a judgment, but that the individual co-defendants personally owned substantial assets; and/or
- if the plaintiff's litigation counsel wanted to try to rattle the employees and pressure them to cooperate as witnesses against their employers (akin to the way that criminal prosecutors will sometimes bring charges against low-level employees to try to "flip" them).

For example: In August 2014, the state of Oregon filed a $3 billion lawsuit against Oracle Corporation *and six Oracle employees personally*, in the wake of the failed attempt to develop Oregon's health-insurance exchange under the Affordable Care Act a.k.a. Obamacare. The six employees sued included five executives at the vice-president level and higher, *as well as a technical manager* who was accused of having conducted a fraudulent demo of the new system's capabilities. The state sought "only" some $45 million from the technical manager, as well as amounts ranging from $87 million to $267 million from various Oracle executives.

To be sure, high-profile lawsuits like this typically settle before trial. Not least, this is because the elected officials who bring or authorize the lawsuits would prefer to trumpet a "victory" instead of rolling the dice with the court. And sure enough, Oregon's lawsuit against Oracle was settled — Oracle agreed to pay Oregon $25 million in cash and provide the state with another $75 million in technology.

But such cases don't always settle; see, for example, the state of Indiana's lawsuit against IBM for allegedly botching the building of a new system for administering the state's welfare programs; that lawsuit dragged on for nearly ten years years and ended (more or less) with a judgment against IBM for some $78 million. See Indiana v. IBM Corp., 138 N.E.3d 255 (Ind. 2019).

In cases of alleged fraud, a court, especially a hometown court, might not give effect to contractual employee protection of this kind. But even so, contractual protective language for individual employees, etc., would be better than nothing.

The language of this Clause draws on ideas proposed by a noted corporate-law practitioner. See Glenn D. West & Natalie A. Smeltzer, Protecting the Integrity of the Entity-Specific Contract: the "No Recourse Against Others" Clause-Missing or Ineffective Boilerplate?, 67 Bus. Lawyer 39, 71-72 (2011). In an email exchange with the present author on August 8, 2012, Mr. West commented that "[b]oth sides of the transaction have the same general interest in protecting the integrity of the entity-specific nature of the contract; and if they don't, this clause smokes that out and there is a real discussion about guarantors."

### 22.80.2 Liability protection

a. Each party agrees not to assert any Contract-Related Claim (see the definition in [BROKEN LINK: k-rel-clm][BROKEN LINK: k-rel-clm]) against any Protected individual unless the Contract expressly states otherwise.

b. Each party agreeing to subdivision a, for itself and any individual or organization claiming through or under it: WAIVES (see the definition in Clause 22.162) AND RELEASES all such Contract-Related Claims against each Protected Individual to the maximum extent not prohibited by law.

c. Subdivisions b and c each apply, without limitation, to all claims of a right to avoid, or to disregard the entity form, of a Contracting Party.

d. Subdivisions b and c each apply regardless whether a waived claim is based on a theory of equity; agency; control; instrumentality; alter ego; domination; sham; single business enterprise; piercing the veil; unfairness; undercapitalization; or otherwise.

e. Subdivisions b and c each apply, without limitation, to any other attempt to impose the liability of a Contracting Party on a Protected Individual.

*Commentary*

This Clause is akin to the so-called Himalaya clause, which has its origins in maritime practice.

### 22.80.3 Nonreliance on Protected Individuals' statements

a. Unless the Contract clearly says otherwise, each party KNOWINGLY DISCLAIMS, AND AGREES NOT TO ASSERT, ANY RELIANCE UPON any

action or omission, including for example any statement or silence, by any Protected Individual, with respect to:

1. the performance of the Contract; and/or

2. any representation or warranty made in, or in connection with, or as an inducement to enter into, the Contract.

b. Tango Clause 22.133 - Reliance Waiver is incorporated by reference into this Clause.

*Commentary*

See also the commentary to Tango Clause 22.133 - Reliance Waiver.

## Clause 22.81 Information Purges

### 22.81.1 Introduction; parties

This Clause applies if and when, under the Contract, a specified party ("*Recipient*") must return or destroy particular information ("*Specified Information*") of another party ("*Discloser*").

*Commentary*

This Clause might be used as part of a confidentiality agreement, in which at some point in time Recipient must purge Discloser's information from Recipient's electronic- and hard-copy files.

Recipient, however, will want to consider pushing back against a blanket obligation to return or destroy copies of Discloser's information. There are several reasons for concern, discussed in the commentary below; in addition:

1. Sometimes both parties forget about the return-or-destruction obligation, which could harm not just Recipient but Discloser as well:

- If Recipient were to forget to comply with the return-or-destruction obligations, then Discloser might use that fact to bash Recipient as a scofflaw in front of a judge or jury.

- On the other hand, suppose that *Discloser* were to fail to follow up to confirm Recipient's return or destruction of Confidential Information (e.g., by failing to ask for a certificate of return or destruction). A third party, learning about that failure, might try to use Discloser's failure to support an argument that Discloser had failed to take reasonable precautions to preserve the secrecy of its information.

2. In many situations, Recipient will want a set of archive copies of what it actually received from Discloser, to guard against an unscrupulous Discloser's later claiming that it had provided more documents or information to Recipient than it actually did.

These issues are addressed in this Clause by allowing Recipient to retain archive copies in accordance with Tango Clause 22.8 - Archive Copies.

### 22.81.2 Definition: *Purge*

The term "*Purge*" refers to returning or destroying all copies and other tangible embodiments ("*Copies*") of the Specified Information that are in Recipient's possession, custody, or control.

*Commentary*

The term *possession, custody, or control* will be familiar to American litigators from Rule 34(a)(1) of the Federal Rules of Civil Procedure, which addresses production of documents and electronically-stored information during pretrial discovery.

### 22.81.3 Triggering of Purge obligation

Recipient need Purge the Specified Information only if Discloser asks Recipient to do so,

in writing,

with Recipient receiving the request no later than 30 days after termination or expiration of the Contract;

otherwise, Recipient need not Purge the Specified Information.

### 22.81.4 Exception for electronic Copies

a. Recipient need not return or destroy *electronic* Copies to the extent that it would be unduly burdensome or costly for it to do so.

b. For example (without limitation), Specified Information in email attachments and system-backup media need not be returned or destroyed.

*Commentary*

In many situations, an obligation to return or destroy documents might not be practical, especially where electronic information is concerned.

Consider litigation discovery of electronically-stored information, or "ESI":

- Anyone who has gone through that process can attest to the burden and expense of even just *identifying* the information that might need to be returned or destroyed.
- The inconvenience and expense of *purging* that information from Recipient's electronic data systems would be even worse.

This section addresses these problems by providing an exception.

### 22.81.5 Checking before *destroying* Copies

a. Before Recipient destroys its Copies of Specified Information, Recipient must advise Discloser, in writing, of Recipient's intent to do so,

in case Discloser does not have its own copies of particular Specified Information;

Recipient's written advice to Discloser may be by any reasonable means, including without limitation email.

b. Recipient must not destroy its Copies unless Discloser either:

1. indicates in writing that Discloser does not need copies of the Specified Information; or

2. fails to respond to Recipient's written advice on or before the date ten business days after Discloser receives or refuses the advice.

*Commentary*

This section takes into account that sometimes Recipient's copies might be the only ones that exist.

### 22.81.6 Recipient's turn-over of Copies if requested

a. This section applies if Discloser, in writing, asks Recipient to return its Copies, instead of destroying them, pursuant to [NONE].

b. In such a case, except as provided in subdivision c: Instead of destroying Recipient's Copies, Recipient must turn over those Copies to Discloser, OR to another party that Discloser designates in writing.

c. If the Copies are electronic, however, then Recipient may instead:

1. make new copies and turn over those new copies to Discloser, and/or

2. decline to make and turn over new copies if, in Recipient's sole opinion, doing so would be burdensome or costly to Recipient.

*Commentary*

Subdivision c might apply, for example, if Recipient was planning to delete electronic copies from its computer system.

### 22.81.7 Written certificate of compliance

a. This section applies if Discloser so requests, in writing,

within a reasonable time after the purge requirement of this Clause becomes applicable (see [NONE]).

b. Recipient must promptly provide Discloser with a written certificate of Recipient's compliance with the requirements of this Clause.

c. The certificate must:

1. be signed by someone having authority to make a binding commitment on Recipient's behalf (or by Recipient him- or herself if an individual);

2. note any known compliance exceptions; and

3. for each exception, note whether and how the exception is authorized by the Contract

(unless doing so is prohibited by applicable law, for example because Recipient has provided Copies to law-enforcement authorities).

*Commentary*

This section requires Recipient to *certify* compliance with the return-or-destruction requirements and to specify any areas of noncompliance. That has several benefits:

- It makes it easier for Discloser to manage its contract rights;
- It gives Recipient an incentive to do a good job in complying with the return-or-destruction requirement;
- It help the parties identify specific areas that might need attention before a dispute arose, and thus possibly help to avoid the dispute in the first place.

BUT: This certification requirement would also give Discloser ammunition to blast Recipient with a "they lied!" accusation, if it turned out that Recipient had overlooked some specimens of Discloser's Confidential Information.

## Clause 22.82 Infringement Remedies

### 22.82.1 Applicability

This Clause is to be read in conjunction with Tango Clause 22.83 - Infringement Warranty.

*Commentary*

This Clause is set out separately from the Infringement Warranty to allow drafters to adopt it on its own if desired.

### 22.82.2 Triggering events

The "*Infringement Remedies*" defined in [NONE] will be available to Beneficiary if one or more of the following "*Triggering Events*" occurs:

1. A court of competent jurisdiction enjoins Beneficiary from using a Covered Product,

    as a result of an infringement claim covered by the Infringement Warranty (a "*Covered Infringement Claim*"),

    and Supplier is unable to promptly have the injunction stayed or overturned; or

2. Supplier notifies Beneficiary (see the definition in Clause 22.112) that Supplier has settled a Covered Infringement Claim on terms that require Beneficiary to stop using a Covered Product; or

3. Supplier notifies Beneficiary that Supplier has determined, in its reasonable judgment, that Beneficiary should stop using a Covered Product because of a Covered Infringement Claim.

*Commentary*

The three items listed above are the basic "stop use" events that might occur in an infringement case.

### 22.82.3 Supplier actions after triggering event

a. IF: A Triggering Event (see the definition in Clause 22.82.2) occurs in respect of a Covered Product;

THEN: Supplier must take at least one of the following remedial actions, selected in Supplier's sole discretion (see the definition in Clause 22.49):

*Plan A – modification or replacement:* Supplier modifies or replaces the Covered Product with a non-infringing substitute that, in material respects, performs the same functions as the replaced deliverable.

*Plan B – license:* For each Beneficiary that was authorized under the Contract to use the Covered Product, Supplier — at its own expense — procures for that Beneficiary the right to continue using Covered Product.

*Plan C – refund:* IF: Supplier is unable to follow Plan A or Plan B; OR: Neither Plan A nor Plan B is commercially feasible in Supplier's sole judgment; THEN: Supplier:

directs the Beneficiary to stop using the deliverable; and

takes the refund action specified in [NONE] below.

b. IF: Supplier proceeds under Plan C above (refund); THEN: Supplier will not be responsible for any infringing use of a Covered Item, by Beneficiary or any other user authorized by the Contract, beginning after a reasonable time for Beneficiary to conduct an orderly transition away from the use in question.

*Commentary*

The above actions seem to be generally accepted as the sensible way for Supplier to proceed.

### 22.82.4 Amount of refund

a. IF: Supplier proceeds under Plan C in [NONE]; THEN:

Supplier must issue a refundable credit for the amount paid for the Covered Product (and/or its use, as applicable),

reduced pro rata to reflect amortization on a straight-line monthly basis of that paid amount over the applicable time period,

as stated in subdivisions b and c below.

b. IF: The refund is for a paid-up, permanent right to use a Covered Item (for example, a deliverable sold outright, or a fee for a paid-up perpetual use license); THEN: The amortization period will be 36 months.

c. IF: The refund is for a temporary period of entitlement relating to a Covered Item (for example, a software maintenance subscription period); THEN: The amortization period will be the entire duration of that temporary period of entitlement.

*Commentary*

Subdivision c: The 36-month amortization period is based on the IRS depreciation period for computer software licenses.

## Clause 22.83 Infringement Warranty

### 22.83.1 Executive summary

a. This Warranty consists of the following:

1. the Copyright & Trade Secret Warranty, defined in [NONE], and

2. the Patent Warranty, defined in [NONE].

b. This Warranty concerns one or more products and/or services clearly specified in the Contract as delivered by a party that is likewise specified ("*Supplier*")

each, a "*Covered Product*" or "*Covered Service*" (as applicable) and, generically, a "*Covered Item*,"

as delivered by Supplier (or as otherwise unambiguously stated in writing by Supplier);

c. This Warranty is intended for the benefit of one or more party or parties clearly identified in the Contract (each, a "*Beneficiary*"); unless the Contract unambiguously specifies otherwise, only the other party to the Contract is a Beneficiary.

d. This Warranty is SUBJECT TO the limitations set forth below.

e. The remedies stated in Tango Clause 22.82 - Infringement Remedies are the Beneficiary's EXCLUSIVE REMEDIES for:

1. any breach of this Warranty; and/or

2. any other alleged- or actual infringement of third-party intellectual property rights by, or attributable to, Supplier.

*Commentary*

*22.83.1.1 Subdivision a: Two components to Infringement Warranty*

This Warranty is divided into the Copyright & Trade Secret Warranty and the Patent Warranty; separating the two will allow drafters to invoke one or the other of them separately. (The two have different hurdles for Supplier to clear, as discussed in their respective definitions below.)

*22.83.1.2 Subdivision b: Whose goods/services are covered?*

Drafters should consider whether this Warranty would apply:

- only to goods and/or services provided directly or indirectly by Supplier itself, e.g., goods manufactured by Supplier and sold via a distribution channel; or
- also to goods and services manufactured and/or distributed by others.

*22.83.1.3 Subdivision b: Warranted "as delivered"*

This Warranty warrants Covered Items *as delivered*, as opposed to warranting their *future performance*; see the discussion of this topic at Section 13.6.3: .

#### *22.83.1.4 Additional background information about warranties*

See generally the reading at Section 13: .

### 22.83.2 Definition: Copyright & Trade Secret Warranty

IF: the Copyright & Trade Secret Warranty is part of the Contract — as is automatically the case whenever this *Infringement Warranty* is part of the Contract;

THEN: Supplier warrants, to Beneficiary, that the specified Covered Item(s), as provided to Beneficiary, do not infringe a copyright, and/or misappropriates a trade secret, owned or assertable by a third party anywhere in the world.

*Commentary*

See the commentary to [NONE] for a discussion of why the copyright- and trade-secret warranty has a different scope than the patent- and industrial-design warranty.

### 22.83.3 Definition: Patent Warranty

a. *No known patent infringement:* IF: The Patent Warranty is part of the Contract — as is automatically the case whenever this Infringement Warranty is part of the Contract;

> THEN: Supplier warrants to Beneficiary that Supplier is not aware (and is not aware of any claim) that the Covered Item itself, as provided to Beneficiary, infringes:
>
> > any valid and enforceable claim of a utility patent or design patent,
> >
> > or any valid and enforceable industrial-design right,
>
> owned or otherwise assertable by a third party anywhere in the world,
>
> > but Supplier does *not* represent or warrant that it has conducted any particular search or other investigation on this point unless Supplier unambiguously states otherwise in writing.

b. *Use of Covered Item:* IF: Supplier unambiguously provides Beneficiary with instructions for using a Covered Item, for example (see the definition in Clause 22.59) in a user manual,

> THEN: The warranty in subdivision a will also apply to *use* of the Covered Item — by Beneficiary and/or by other any users unambiguously specified in the Contract — in accordance with those instructions.

*Commentary*

*22.83.3.1 Subdivision a: Limited warranty*

A supplier can more readily warrant against claims of infringement of third-party *copyrights* or misappropriation of *trade secrets* than it can against infringement of *patents*. That's because:

- for copyright- and trade-secret warranties, "independent creation" — if proved — is generally an absolute defense; and
- where patents are concerned, a supplier's products might unknowingly infringe an obscure patent that "pops up from out of the woodwork," perhaps asserted by one of the so-called patent trolls (many of whom get offended if called that: they insist that they are "non-practicing entities" or NPEs or "patent assertion entities" or "PAEs").

A supplier often wouldn't even be in a position to know whether it infringed any third-party patents without commissioning a so-called "freedom to operate" patent search and legal opinion; those are expensive and often are not obtained. In contrast, the supplier generally *will* be in a good position to know, without whether it improperly copied from a third party's protected subject matter. That in turn puts the supplier in a better position to warrant *noninfringement* as to copyrights and trade secrets, whereas in this section the supplier only warrants that *it has no knowledge* of any actual- or claimed *patent* infringement.

For more about the basics of *patent* infringement, see the commentary at Section 21.10: .

*22.83.3.2 Subdivision b: Use of Covered Items*

In U.S. patent law, you can infringe a patent claim to a product by *using* — without a license from the patent owner — a product that comes within the scope of the claim. (See generally the discussion of patent infringement in the commentary at Section 21.10: .)

This infringement-by-use doctrine is relevant here because under U.S. law, supplier can be *indirectly* liable for the patent infringement *of others* if Supplier "actively induced" the infringement — and Supplier's providing instructions to Beneficiary might qualify. See 35 U. S. C. § 271(b), *explained in* Limelight Networks, Inc. v. Akamai

Technol., Inc., 572 U.S. 915, 134 S. Ct. 2111 (2014) (reversing Federal Circuit), *on remand*, 797 F.3d 1020 (setting forth doctrine of "divided [direct] infringement" as possible predicate for active inducement).

This section refers to infringement by Covered *Items*, not just of Covered *Products*, because a patent claim could arise from *Beneficiary's* use of a Covered Service provided by Supplier.

### 22.83.4 Excluded: Compliance with a furnished specification

a. This Warranty does not obligate Supplier to take action in response to any claim of infringement where both of the following are true:

1. the claimed infringement arises from a Covered Item's compliance with a written- or oral specification

(see also subdivision b for assertions of compliance with *oral* specifications); and

2. the specification was provided, under the Contract:

by any Beneficiary;

or by any affiliate (see the definition in Clause 22.2) of a Beneficiary (to avoid possible collusion);

or by a third party on behalf of a Beneficiary or affiliate of a Beneficiary.

b. IF: Supplier asserts that the Covered Item complied with an *orally*-provided specification;

THEN: Supplier must prove that assertion by clear and convincing evidence (see the definition in Clause 22.30).

*Commentary*

This section mirrors the general law in the U.S. in the Uniform Commercial Code § 2-312(3), which provides that:

> Unless otherwise agreed a seller who is a merchant *[see the commentary at Section 2.9.2: ]* regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like
>
> *but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications*.

(Emphasis and extra paragraphing added.)

### 22.83.5 Excluded: Combination-only claims

Supplier need not take any action in response to any claim of infringement by a Covered Item,

where the claimed infringement arises from a combination of the Covered Item with any other tangible- or intangible products or services,

if no claim of infringement is made in respect of:

1. the Covered Item itself, nor
2. use of the Covered Item apart from the combination.

*Commentary*

Note: This section disclaims *warranty* liability *to Beneficiary*. But that might not be enough to save Supplier from liability to *a patent owner* who claims that Supplier is liable for "contributory infringement" of a patent claim. That's because under U.S. law —

> Whoever offers to sell or sells within the United States or imports into the United States
>
> a component of a patented machine, manufacture, combination or composition, or a material or apparatus for use in practicing a patented process,
>
> constituting a material part of the invention,
>
> knowing the same to be
>
> - especially made or especially adapted for use in an infringement of such patent,
> - and not a staple article or commodity of commerce suitable for substantial noninfringing use,
>
> shall be liable as a contributory infringer.

35 U. S. C. § 271(c) (extra paragraphing added); see generally Contributory infringement (Law.Cornell.edu).

### 22.83.6 EXCLUSIVE WARRANTY

a. This section applies in any case in which the Contract includes the Infringement Warranty unless the Contract expressly states otherwise, specifically mentioning and overriding the Infringement Warranty.

b. This Warranty states the EXCLUSIVE TERMS of any warranty concerning infringement of third-party rights by one or more Covered

Items.

c. All other warranties, representations, conditions, and terms of quality relating to infringement are DISCLAIMED by Supplier and WAIVED (see the definition in Clause 22.162) by each party other than Supplier.

*Commentary*

See also the discussion of implied-warranty disclaimers at Section 13.4: .

## Clause 22.84 Inspections Protocol

### 22.84.1 Introduction; parties

This Clause applies if and when, under the Contract, a specified party ("*inspecting party*") is authorized to have one or more inspections, audits, or other examinations (collectively, "*Inspections*") conducted of facilities, products, books, records, or other items of another party (a "*host*").

*Commentary*

*"You get what you INspect, not what you EXpect." (Attributed to Admiral Hyman G. Rickover, USN (1900-86), the father of the nuclear Navy.)*

Typically, a "host" might be a supplier, while the "inspecting party" might be a customer.

*Note to students: Be sure to read Section 21.5: about why inspections can be worthwhile*.

### 22.84.2 Advance notice of inspection

The inspecting party must give the host at least ten business days' advance notice of any desired Inspection, EXCEPT:

1. for good reason (see the definition in Clause 22.84.11); or

2. as otherwise agreed.

*Commentary*

Sometimes surprise inspections make sense, but often it makes just as much sense to give the host time to clean things up on its own.

### 22.84.3 Deadline for completion of inspections

The inspecting party must ensure that each Inspection is completed no later than five business days after the effective date of the notice of the Inspection, *unless* more time is needed for good reason (see the definition in Clause 22.84.11).

*Commentary*

Having inspectors hanging around for a long time can be a burden to the host, so it's useful to set a default completion deadline.

### 22.84.4 Permissible inspectors

Inspections may be performed by one or more inspectors that the inspecting party proposes to the host, in writing,

if the host does not respond, in writing, within a reasonable time, with a reasonable objection to the proposal.

*Commentary*

This section sensibly defers the issue of just who can conduct an inspection. (On the other hand, some parties might want to lock down that point.)

For a host supplier, one scary scenario might be that a competiting supplier is trying to get a customer's business, and offers to provide the customer, at no charge, with an inspector to "evaluate" the host supplier. It's not hard to imagine how that scenario might not end well.

### 22.84.5 Working hours for Inspections

The host — in consultation with the inspecting party — may make reasonable decisions about just when an Inspection is to be conducted,

for example, what day(s) and what time(s) of day,

with a view toward balancing the needs of the Inspection against possible interference with the host's business.

*Commentary*

The working-hours issue addressed in this section is distinct from the advance-notice issue, which is dealt with in [NONE].

Note how this section leaves it up to the host —

- to make *reasonable* decisions,
- *in consultation* with the inspecting party.

### 22.84.6 Required workspace for inspectors

a. The host must provide the inspector(s) with reasonable, visitor-type facilities,

such as office space and -furniture, lighting, air conditioning, electrical outlets, and Internet access,

all of the type customarily used by office workers.

b. The inspector(s) are responsible for bringing, setting up, and using any equipment necessary for the Inspection.

*Commentary*

This section sets out some very-basic requirements of professional courtesy.

### 22.84.7 Inspector access to host personnel

The host must require its personnel to provide reasonable cooperation with the inspectors,

including without limitation answering reasonable questions from the inspectors,

to the extent not inconsistent with this Clause.

*Commentary*

Cooperation from host personnel can make an inspection go more smoothly and swiftly, but *voluntary* cooperation might not always be forthcoming; hence, this sec-

tion's requirement.

### 22.84.8 Confidentiality obligations

a. The inspecting party must comply with [PH] concerning any non-public information maintained by the host that the inspecting party learns via the Inspection.

b. The inspecting party must not use non-public information learned through the Inspection, except for:—

1. correcting discrepancies identified in the Inspection; and/or
2. enforcing the inspecting party's rights under the Contract.

c. The inspecting party must ensure that its inspectors have agreed in writing to comply with the obligations of this section.

*Commentary*

The uses allowed by the above restrictions will often be enough for the inspecting party's purposes.

Subdivision c: Inspectors *might* have their own professional obligations to maintain confidentiality, but it's good to be clear on that subject.

### 22.84.9 Certain information off-limits to inspectors

The host must give inspectors access to all information reasonably related to the subject of the Inspection,

except that the host need not give inspectors access to information if, under applicable law, the information would be immune from discovery in litigation,

for example due to attorney-client privilege, work-product immunity, or any other privilege.

*Commentary*

Some host parties might want to specify that additional categories of information are off-limits.

### 22.84.10 Information permitted in Inspection reports

Inspectors may report their findings to the inspecting party, subject only to any applicable confidentiality restrictions.

*Commentary*

Alternative:

> Inspectors may not disclose to the inspecting party more than the following: (i) whether the Inspection revealed a reportable discrepancy, and if so, (ii) the size and general nature of the discrepancy.

### 22.84.11 Definition: Good reason

a. *Basic definition:* For purposes of this Clause and any other Inspection-related provisions of the Contract, the term *good reason* includes, without limitation, any one or more of the following:

1. significant lack of cooperation by the host; and/or
2. the discovery of substantial evidence of:

   fraud, or

   material breach (see the definition in Clause 22.102.2) of the Contract,

in either case by, or attributable to, the host.

b. *Disputes over good reason:* In any dispute between the parties in which good reason is the applicable standard, the parties will handle the dispute in accordance with Tango Clause 22.52 - Dispute Management, which incorporates by reference Tango Clause 22.19 - Baseball Arbitration.

*Commentary*

This definition is intentionally vague, but subdivision b will steer the parties into a Tango dispute-management protocol that's designed to enhance the chances of settlement.

### 22.84.12 Survival of Inspection rights

The Inspection-related provisions of the Contract, including but not limited to those of this Clause:

1. will survive any termination or expiration of the Contract — but only as to matters that would have been subject to Inspection before termination or expiration; and

2. will remain subject to all deadlines and other limitations stated in the Contract.

*Commentary*

Caution: Not specifying that inspection rights survive termination of an agreement might result in the inspection right ending when an agreement does. That happened in a case in which a union benefits fund tried to audit an employer's contributions to the fund, as permitted by its agreement with the employer — but this was after the employer had terminated its agreement to participate in the fund. The court held that the union's audit right had died with the agreement. See New England Carpenters Central Collection Agency v. Labonte Drywall Co., 795 F.3d 271 (1st Cir. 2015) (affirming district court's judgment after bench trial).

## Clause 22.85 Intellectual property definitions

### 22.85.1 Intellectual Property Definition

The term "*intellectual property*," whether or not capitalized, refers broadly to:

1. approaches, concepts, developments, discoveries, formulae, ideas, improvements, inventions, know-how, methodologies, plans, procedures, processes, techniques, and technology, whether or not patentable;

2. artwork, audio materials, graphics, icons, music, software, writings, and other works of authorship;

3. designs, whether or not patentable or copyrightable;

4. trademarks, service marks, logos, trade names, and the goodwill associated with each;

5. trade secrets and other confidential information;

6. mask works; and

7. all other forms of intellectual property recognized by law.

*Commentary*

This definition compiles language commonly found in various contracts that have been drafted with input from IP lawyers (including the present author).

### 22.85.2 Intellectual Property Right Definition

a. The term "*intellectual-property right*," whether or not capitalized, refers broadly to any right,

existing under any form of intellectual-property law or industrial-property law (see the partial list in subdivision b below),

to exclude others from utilizing one or more forms of intellectual property (see the definition in Clause 22.85.1),

at a relevant time, in a relevant location,

including without limitation the right to seek monetary- and/or injunctive relief,

in any judicial, administrative, or other forum having jurisdiction in that location,

for present or past infringement of any such right.

b. The term *intellectual-property right* includes, for example (see the definition in Clause 22.59):

1. all rights (whether registered or unregistered) in, or arising under laws concerning:

trade secrets and other confidential information;

inventions, utility patents, and industrial designs;

trademarks, service marks, and trade names;

Internet domain names;

copyrights;

designs;

rights of publicity;

and mask works;

2. any application then pending for such a right (where applicable),

    including for example an application for a patent or to register a copyright or trademark;

3. any right to file such an application; and

4. any right to claim priority for such an application.

*Commentary*

This definition spells out in great detail, for the benefit of students and other newcomers to the field, what IP professionals implicitly know but seldom state explicitly. It's a composite of language commonly found in contracts that have been drafted with input from IP lawyers.

Subdivision b.2: Copyrights, trademark rights, and trade-secret rights can arise automatically (in most jurisdictions) without the need for registration with government authorities, although registration might be required to take advantage of certain legal remedies. See generally [TO DO: Links].

## Clause 22.86 Intellectual Property Ownership

### 22.86.1 Applicability

This Clause applies if and when under the Contract, one or more parties will be involved in creating new subject matter that is protectable by intellectual-property laws, such as (without limitation) patents and copyrights; such subject matter is referred to as "intellectual property" or "IP."

*Commentary*

See also Tango Clause 22.85 - Intellectual property definitions and their commentary.

### 22.86.2 Definition: Ownership (of IP)

In respect of particular IP, the term "*ownership*" (and related terms such as "*own*") — whether or not capitalized — refers to:

> legal- and equitable ownership of all right, title, and interest in that IP, anywhere in the world,
>
> under any law relating to IP, such as (without limitation), laws governing patents, copyrights, trade secrets, mask works, industrial designs, and trademarks.

*Commentary*

*22.86.2.1 Trademarks [FIX THIS*

*$$$]*

Trademarks: If a party is assigning IP rights in a technology, an assignment of *trademark* rights might *or might not be* part of the deal as contemplated by the parties — because the assigning party might not want to give up control of the "brand" associated with the rights.

*22.86.2.2 Background: Patent ownership*

In the United States, the general rules about patent ownership can be summarized as follows:

• Inventors initially own the legal rights (if any) to their inventions. See generally 35 U.S.C. § 111(a)(1) (inventor may apply for patent).

• *Joint* inventors ("co-inventors") of an invention jointly own the invention. See 35 U.S.C. § 262.

• Transfers of patent *ownership* (or exclusive licenses) generally must be in writing. See 35 U.S.C. § 261.

• An employee who was "hired to invent" or "set to experimenting" will usually be considered to have an *implied* obligation to assign the invention rights to the employer. See, e.g., Teets v. Chromalloy Gas Turbine Corp., 83 F.3d 403, 408-09 (Fed. Cir. 1996); Miller v. GTE Corp., 788 F. Supp. 312 (S.D. Tex. 1991). (Disclosure: In *Miller*, the present author represented GTE, which later became Verizon).

But in a Nebraska federal case, a company was found *not* to have set its former employees to experimenting, and therefore the company did not own the rights in anew product that the former employees developed at a startup company that they founded. Farmers Edge Inc., v. Farmobile LLC, 970 F.3d 1027, 1032 (8th Cir. 2020) (affirming summary judgment in favor of defendant).

#### *22.86.2.3 Background: Copyright ownership*

In the United States, the general rules about *copyright* ownership can be summarized as follows:

• The "author" of a copyrighted work initially owns the copyright; joint authors likewise co-own their jointly created work. See 17 U.S.C. § 201(a).

• For copyright purposes, an employer is considered the "author" of a copyrighted work if the work is a "work made for hire"; see 17 U.S.C. § 201(b) and the detailed discussion at Section 22.86.6.1: .

• Transfers of copyright *ownership* (including transfers of the individual exclusive rights that, together, comprise a copyright) must be in writing. See 17 U.S.C. § 201(d). But a simple writing for ownership transfer will suffice — as the Ninth Circuit noted: "It doesn't have to be the Magna Charta; a one-line pro forma statement will do." Effects Assoc., Inc. v. Cohen, 908 F.2d 555, 557 (9th Cir. 1990) (affirming summary judgment).

### 22.86.3 No change of ownership of pre-existing IP

Ownership of any pre-existing IP will not change under the Contract unless the Contract clearly says otherwise.

*Commentary*

This more or less mirrors the applicable law in the U.S.; see 17 U.S.C. § 261 (transfers of patent ownership); 17 U.S.C. § 201(d) (transfers of copyright ownership).

### 22.86.4 Ownership of newly-created IP (if any)

As between the parties:

1. Each party will own whatever IP that it creates on its own under the Contract (if any); and

2. The parties will jointly own — in equal, undivided interests — whatever IP that they jointly create under the Contract, if any; see also Rules 22.86.7, 22.86.8, and 22.86.9 concerning joint works.

*Commentary*

*22.86.4.1 Alternative*

> *[Specify party name]* will own all such IP except Tookit Items (see [NONE]).

*22.86.4.2 Why this Clause says, "As between the parties …."*

The above "as between the parties" language recognizes that other factors — such as preexisting contracts — might affect ownership of newly-created IP. *Example:* Stanford University found, presumably to its dismay, that it did not own the entirety of a significant biotech invention by its researchers because one of the researchers had previously signed away his rights to a company that provided him with some technical training. See Bd. of Trs. of the Leland Stanford Junior Univ. v. Roche Molecular Sys., Inc., 583 F.3d 832 (Fed. Cir. 2009), *aff'd as to a tangential issue,* 563 U.S. 776, 131 S. Ct. 2188, 2194-95 (2011).

*22.86.4.3 Include "work made for hire" language for non-employee creations?*

As in so many areas of law and business, the answer to the question, *should the contract include work-made-for-hire language?,* is a definitive "it depends." In some situations where intellectual property is to be (or might be) created, the hiring party might want the contract to state that the IP will be a "work made for hire," in part so that the human author won't have the right to recapture the ownership after 35 years have elapsed (as Paul McCartney did), as discussed in the commentary to [NONE]. **Note:** *Merely saying that something will be a work made for hire isn't enough to make it so*, as discussed in that commentary.

*22.86.4.4 Special case: Who should own custom-developed computer software?*

It's a sad tale: A customer hires a software developer *as an independent contractor* to create custom software for the customer's business. The relationship eventually breaks down, and the parties get into a dispute over who owns the copyright in the software: The developer, or the customer?

If the contract says only that the software is to be a "work made for hire" *but* the software doesn't fit into one of the nine statutory categories listed above, the parties can settle in for some expensive litigation. See, e.g., Siniouguine v. Mediachase Ltd., No. CV 11-6113, slip op. at part III.A.1 (C.D. Cal. June 11, 2012). In that case, the court held that the software in question was a work made for hire, but the court seems to have misread the statute, apparently believing that software could qualify as a work made for hire merely by being "specially commissioned," as long as the parties' agreement stated that the software was a work made for hire.

(The court also found, however, that the software qualified as a contribution to a collective work and as a compilation; that the developer had assigned the copyright

to the customer in writing; and that the developer was in fact an employee of the customer and had been working within the scope of his employment. The case was later settled, with the court entering a consent judgment that the customer owned the software and invalidating the developer's copyright registration.)

In the present author's experience, a reasonable compromise is the following:

- the customer owns any newly-created IP that's unique to the customer's business *or* that involves the customer's confidential information;
- the software developer owns all other IP created by the developer, so that the developer is free to reuse that IP in working for other customers.

That basic arrangement is reflected in the ownership provisions of this Clause.

#### *22.86.4.5 Economic rationale for ownership rule*

When a software developer, graphic artist, or other creator is developing IP for a customer, that customer should keep in mind that:

- the pricing quoted by the IP creator will be determined in part by the IP creator's ability to reuse IP previously created for *past* customers;
- consequently, if the *current* customer insists on owning *any* IP that's created on the customer's dime, then the IP creator is likely to insist on revisiting the pricing and other economic terms of the deal.

#### *22.86.4.6 Caution: The law might limit employers' ownership*

A California statute: • limits an employer's ability to require employees to assign their spare-time inventions to the employer; • states that contrary provisions in employment agreements are unenforceable; and • prohibits employers from requiring such provisions as a condition of employment or continued employment. See Cal. Labor Code §§ 2870-2872.

Some other states have similar laws; the following list might be out of date:

- Del. Code. Ann. 805
- 765 Ill. Code 1060
- Minn. Stat. 181.78
- N.C. Gen. Stat. §§ 66-57.1 - 66.57.2
- Wash. Rev. Code 49.44.140

In addition, a federal court held that a provision in an employment agreement, purporting to require assignment of *post-employment* inventions, was effectively a non-competition covenant that was unenforceable under a separate provision of California law. See Whitewater West Industries, Ltd. v. Alleshouse, No. 2019-1852 (Fed. Cir. Nov. 19, 2020) (reversing judgment after bench trial), *citing* Cal. Bus. & Prof. Code § 16600.

#### *22.86.4.7 An implied license might save the day for a hiring party*

A hiring party might not be in a hopeless position simply because the work it paid to have created was not a "work made for hire" nor a joint work and the hiring party cannot obtain an assignment. The hiring party might well be able to assert at least a use right in the created work, and possibly even more than that.

Selected cases:

• Asset Marketing Systems, Inc. v. Gagnon, 542 F. 3d 748 (9th Cir. 2008): An independent contractor computer programmer sued his client for copyright infringement because the client had continued to use software developed by the programmer after the parties' relationship deteriorated. The appeals court affirmed summary judgment that the programmer could not assert his copyrights against the client, on grounds that the programmer had *implicitly* granted the client "an unlimited, nonexclusive, implied license to use, modify, and retain the source code" of the software. *See id.* at 750.

• Graham v. James, 144 F.3d 229, 235, 238 (2d Cir.1998): The appellate court vacated and remanded a copyright infringement award, on grounds that the infringement defendant was an implied licensee.

• Effects Assoc., Inc. v. Cohen, 908 F.2d 555, 557 (9th Cir. 1990) (affirming summary judgment): A movie producer commissioned special-effects footage for a horror movie but did not pay for it. In an opinion by Judge Kozinski, the court rejected a claim that the producer was a copyright infringer, holding that the movie producer had *orally* been granted an implied non-exclusive license (and thus the copyright owner's action would have to be in contract, not copyright). The court noted pointedly that the dispute over copyright would not have arisen had the parties reduced their agreement even to a one-line writing.

• Oddo v. Ries, 743 F.2d 630, 634 (9th Cir. 1984): An author prepared a manuscript as part of his partnership duties. The court held that the author had implicitly given the partnership a license to use the articles, "for without a license, [the author's] contribution to the partnership venture would have been of minimal value."

• Millennium, Inc. v. SAI Denver M. Inc., No. 14-cv-01118, slip op. (D. Colo. Apr. 20, 2015) (granting defendant Mercedes-Benz dealership's motion for summary judgment that plaintiff video-production company had granted dealership an implied license to use advertisement and dismissing copyright-infringement claim), *citing Graham and Effects Assoc.*

• Holtzbrinck Publishing Holdings, L.P. v. Vyne Communications, Inc., No. 97 CIV. 1082 (KTD), 2000 WL 502860 at *10 (S.D.N.Y., Apr. 25, 2000): The parent company of *Scientific American* magazine commissioned a consultant to develop programming for the magazine's Web site. The court granted partial summary judgment that the company had an irrevocable non-exclusive license to the programming.

• Yojna, Inc., v. American Medical Data Systems, Inc., 667 F. Supp. 446 (E.D. Mich. 1987): An outside software contractor, at the request of a hospital corporation and its subsidiary, developed a computer program for hospital information management. The court held that the outside contractor was the owner of the software, but the subsidiary had a perpetual, royalty-free license to use and sublicense the program, including the right to unrestricted access to source code for purposes of developing new versions and enhancements. The court also held that the license was an exclusive license within the health-care industry. *See id.* at 446.

Some courts, however, have held that *employers* do *not* have such rights in works created by their employees. Selected cases:

• Avtec Systems, Inc. v. Peiffer, 21 F.3d 568 (4th Cir. 1994), *vacating and remanding* 805 F. Supp. 1312 (E.D. Va. 1992), *on remand* 1994 U.S. Dist. LEXIS 16946 (E.D. Va. Sept. 12, 1994): Peiffer, a former employee of Avtec, had written a computer program in part on company time and in part on his own time. The Fourth Circuit held that if Peiffer was the owner of the copyright in the computer program, then Avtec would have had only a nonexclusive license to use the program, which would be revocable absent consideration. The court disapproved a holding below that Avtec had a "shop right" in the software; it noted that Congress had expressly declined to import the shop right doctrine from patent law into copyright law. *See id*. at 575 n.16.

• Kovar v. Southeastern Michigan Transportation Authority, slip op., No. 101761 (Mich. App. Oct. 4, 1989), *reprinted in* Comp. Industry Lit. Rptr. 10,317 (Oct. 23, 1989): A former employee of the transit authority, who worked as a schedule writer, had developed scheduling software "in his spare time on the job and at home" [emphasis added] but had kept the source code and passwords as secrets from his employer. The employee resigned to take another job and offered the transit authority a use license for an annual fee; his supervisor "fired" him, unsuccessfully demanded that he turn over his source code and passwords, called in the district attorney to have him arrested for "extortion" and "destruction of computer programs," and advised his new employer that the former employee was under investigation for extortion. *Id.*, slip op. at 2. The court implicitly held that the transit authority did not have a license to use the scheduling software.

### 22.86.5 No change of ownership of Toolkit Items

a. This section applies unless the Contract clearly states otherwise.

b. Even if other IP is transferred under the Contract, ownership of "Toolkit Items" (defined below) will not change;

> without limitation, this means that any Toolkit Items created under the Contract are not to be deemed "works made for hire."

c. For this purpose, "*Toolkit Item*" refers to any concept, idea, invention, strategy, procedure, architecture, or other work, that:

1. is, in whole or in part, created by a party in the course of performing under the Contract; but

2. in the case of a provider performing services for a customer: is not specific, and/or is not unique, to the customer and its business.

d. In case of doubt, however, the term *Toolkit Item* does not encompass Confidential Information, as defined in Tango Clause 22.34 - Confidential Information, of another party.

*Commentary*

The definition of "Toolkit Item" comes into play if a service provider wants to retain ownership of the "tooling" that it develops in the course of a project for a client or customer, even if the customer is to own the resulting work product.

### 22.86.6 No work-made-for-hire status

Newly-created IP will not be a "work made for hire" unless the Contract clearly says so.

*Commentary*

#### *22.86.6.1 "Scope of employment" works made for hire*

If a copyrighted work is created by an employee who is working within the "scope of employment," then the *employer* is considered the "author" of the work. See 17 U.S.C. § 101 (definition of "work made for hire").

In a unanimous opinion in Community for Creative Non-Violence v. Reid, 490 U.S. 730 (1989), Justice Marshall set out a "nonexhaustive" list of traditional factors that are to be considered, under the general common law of agency, in determining whether an individual author is or isn't working within the scope of employment; the list focuses on the extent to which the putative employer has the right to control the means and manner by which the author creates the work; "[n]o one of these factors is determinative." *See id.* at 751-52, *citing* Restatement of Agency § 220(2).

#### *22.86.6.2 "Outside contractor" works made for hire*

A different situation arises when a party engages *a nonemployee* to create a copyrightable work: The *hiring party* can be considered the "author" of the work, but only if both of the following things are true:

1. the work is "specially ordered or commissioned" for use in one of nine statutory categories, listed below; *and*

2. the actual author(s) and the commissioning party agree, in a written agreement — which should be signed *before* the work is created, as discussed below — that the work will be a work made for hire. See 17 U.S.C. § 101 (definition of "work made for hire");

In the first item just above, the nine referenced statutory categories are the following:

- a contribution to a collective work,
- a part of a motion picture or other audiovisual work,
- a translation,
- a supplementary work *(see below)*,
- a compilation,
- an instructional text *(see below)*,
- a test,
- answer material for a test, or
- an atlas.

The Supreme Court has said that these statutory categories represent a conscious compromise by Congress as to when the rights of non-employee authors can be permanently appropriated in advance by hiring parties. See Community for Creative Non-Violence v. Reid, 490 U.S. at 745-46.

(Note that rights assigned to a hiring party, as opposed to rights owned ab initio by virtue of hiring party's "authorship," can be reclaimed by author or heirs 35 years after assignment, as discussed in the next section.)

Section 101 of the statute further provides that:

- a "supplementary work," as used in the above laundry list, is a work prepared for publication as a secondary adjunct to a work by another author for the purpose of introducing, concluding, illustrating, explaining, revising, commenting upon, or assisting in the use of the other work, such as forewords, afterwords, pictorial illustrations, maps, charts, tables, editorial notes, musical arrangements, answer material for tests, bibliographies, appendixes, and indexes; and
- an "instructional text" is a literary, pictorial, or graphic work prepared for publication and with the purpose of use in systematic instructional activities.

#### *22.86.6.3 Work-for-hire status and copyright-recapture rights*

Work-for-hire status makes a difference in the long term: In the U.S., if an author transfers or licenses a copyright *and the work is not a work made for hire,* then

(years later) the author or his or her heirs can terminate the transfer or license and, in essence, "recapture" the author's ownership. See 17 U.S.C. § 201(b) (ownership of work made for hire); 17 U.S.C. § 203 (termination of copyright transfers and licenses); see also the Copyright Office explanation.

This issue has come up for some famous songwriters, e.g., Paul McCartney, who sought to revoke his transfer of his song copyrights. See, e.g., Stan Soocher and Scott Graham, Paul McCartney's Suit over Songs' Recapture Rights (LawJournalsNewsletters.com 2017). McCartney's lawsuit reportedly was settled. See Ashley Cullins, Paul McCartney Reaches Settlement With Sony/ATV in Beatles Rights Dispute (HollywoodReporter.com 2017).

For other examples of well-known copyrights being recaptured, see Stephen K. Rush, A Map Through the Maze of Copyright Termination: Authors or Their Heirs can Recapture Their Valuable Copyrights (NVLawLLP.com, undated).

#### *22.86.6.4 Advantage of a formal work-made-for-hire agreement*

If a copyrightable work is created by an employee working within the scope of his or her employment, then a work-made-for-hire agreement won't be needed (but it's still a very good idea, to help educate all concerned).

For *non*-employee works, a work-made-for-hire agreement is "a must" under U.S. law. (And if the work doesn't fit into one of the statutory categories listed above, then the work *won't* be a work made for hire, no matter what the parties' agreement might say.)

#### *22.86.6.5 Work-made-for-hire agreement — retroactive effect?*

The Copyright Act doesn't say when a written work-made-for-hire instrument must be signed; a circuit split exists as to whether the instrument must be signed before the work is created, or whether it can be signed afterwards. As summarized by the influential Second Circuit:

> Although the Seventh and Ninth Circuits have ruled that an agreement sufficient to establish a work as a "work for hire" must be executed before creation of the work, see Schiller & Schmidt, Inc. v. Nordisco Corp., 969 F.2d 410, 412-13 (7th Cir. 1992); Gladwell Government Services, Inc. v. County of Marin, 265 F. App'x 624, 626 (9th Cir. 2008), our Circuit has ruled that in some circumstances a series of writings executed after creation of the works at issue can satisfy the writing requirement of section 101(2), see Playboy Enterprises, Inc. v. Dumas, 53 F.3d 549, 558-59 (2d Cir. 1995).
>
> Such writings, we said, must "confirm[] a prior agreement, either explicit or implicit, made *before* the creation of the work." Id. at 559. That statement is best understood as qualified by the particular circumstances of the execution of the writings in that litigation.

Estate of Kauffmann v. Rochester Inst. of Tech., 932 F.3d 74, 77 (2d Cir. 2019) (reversing district court judgment; movie reviews were not works made for hire) (footnotes omitted, alterations by the court, emphasis and extra paragraphing added).

### 22.86.7 Authorized use of *jointly-created* new IP

Either party may make whatever use it desires of any IP that is jointly created in the course of performance under the Contract.

*Commentary*

Joint creation of intellectual property can occur, for example:

- in services-type contracts; and
- in collaboration agreements of various kinds, e.g., R&D joint-venture agreements.

Who is to own jointly created IP will sometimes be a negotiation point.

### 22.86.8 No accounting obligation for use of jointly-created IP

IF: A party makes use of IP that it jointly created with another party;

THEN: The first party need not account to the other party for such use;

for example, the first party need not share profits with the other party, nor pay royalties to the other party.

*Commentary*

On the **patent** side: Unless otherwise agreed in writing, each co-inventor of joint invention may use and/or license the invention *with no obligation* to account to — i.e., share proceeds with, or pay a royalty to — any other co-inventor.

See 35 U.S.C. § 262.

On the other hand, on the **copyright** side: While the co-owners of a joint work may make use of the work as they see fit, *they must account to one another* from their uses of the work unless they agree otherwise in writing. As an example of this principle, the hit song *Let the Good Times Roll* was putatively authored by one Leonard Lee; he and his heirs were paid more than $1 million in royalties during the relevant time period. But Lee's childhood friend Shirley Goodman won a lawsuit in which she alleged that she was the co-author of the song — the court awarded her one-half of those royalties.

See Goodman v. Lee, 78 F.3d 1007 (5th Cir. 1996).

Another example is the 1967 hit song A Whiter Shade of Pale by the British rock group Procol Harum: In 2009, the group's organist, Matthew Fisher, prevailed in the

House of Lords on his claim that he should have been listed as a co-author of the song as released, because the Bach-like part that he played on the organ during the recording session was an addition to the original composition. The Lords agreed that Fisher had waited too long — 38 years — to claim his share of past royalties. But the Lords affirmed a judgment below that Fisher was entitled to *a 40% share of ownership in the musical copyright* in the song, and thus presumably to that share of future royalties.

See Fisher v. Brooker, [2009] UKHL 41. Click https://www.youtube.com/watch?v=Mb3iPP-tHdA to hear the song.

### 22.86.9 Licensing others to use jointly-created IP

Each party may authorize others to use jointly-created IP,

in any manner that would be allowed to the authorizing party itself under the Contract,

including without limitation use of the IP for the authorizing party's benefit — this is sometimes referred to as "have-made rights" —

and/or to use the IP for the user's own benefit as a licensee of the authorizing party.

*Commentary*

In a Second Circuit case, schools paid FedEx Office to make copies of materials that were licensed under a Creative Commons license that prohibited "commercial use." The court held that the copying still qualified as noncommercial, even though FedEx had charged the schools for making the copies: "[U]nder long–established principles of agency law, a licensee under a non–exclusive copyright license may use third–party assistance in exercising its license rights unless the license expressly provides otherwise." See Great Minds v. FedEx Office & Print Servs., Inc., 886 F.3d 91, 94 (2d Cir. 2018).

### 22.86.10 Present transfer of later-arising IP rights

a. This section applies if, under the Contract:

an individual or organization (the "*Owner*") is to be the owner of specified intellectual property that will be or might be created in the future;

but by law the specified IP is or might be owned by another individual or organization ("*ABC*"),

as opposed to being automatically owned by the Owner upon creation (as in, for example, the case of a "work made for hire" under copyright law).

b. For any case described in subdivision a, ABC HEREBY ASSIGNS all right, title, and interest in all such specified IP to the Owner;

BUT IF: By law, any moral rights or other intellectual property rights in the specified IP cannot be assigned to the Owner;

THEN: ABC hereby grants to the Owner a perpetual, irrevocable, worldwide, royalty-free, fully transferable license, under all such non-assignable rights.

*Commentary*

The *present* assignment of *future* rights made a huge difference to Stanford University, which found, presumably to its dismay, that it did not own the entirety of a significant biotech invention by its researchers:

- One of the researchers spent some time at a company, Roche, to obtain technical training;
- The researcher signed a "visitor NDA" with Roche;
- Roche's visitor NDA contained "hereby assigns" language, under which the researcher made a {}/present/ assignment of any rights in *future* inventions that he helped to invent using what he had learned at Roche;
- In contrast, the researcher's already-existing agreement with Stanford stated that the researcher *would* assign his rights in future inventions.

The Federal Circuit held that the Roche agreement's present-assignment language took precedence over the Stanford agreement's future-assignment provision, even though Stanford and the researcher had entered into the latter agreement before the researcher entered into the Roche agreement. See Bd. of Trs. of the Leland Stanford Junior Univ. v. Roche Molecular Sys., Inc., 583 F.3d 832 (Fed. Cir. 2009), *aff'd as to a tangential issue,* 563 U.S. 776, 131 S. Ct. 2188, 2194-95 (2011).

Subdivision b – license under moral rights: This is an anchor-to-windward provision. See generally the Wikipedia entry on moral rights.

### 22.86.11 Arrangements with parties' employees, etc.

a. This section applies as to any particular IP that, under the Contract, is to be owned by an Owner (see the definition in Clause 22.86.10).

b. Each *other* party must ensure that its relevant employees,

and its subcontractors (if any),

have signed (and, if applicable, notarized) written agreements sufficient to enable that other party to comply with any obligations that the other party has under this Clause.

a. In case of doubt: This section in itself neither authorizes nor prohibits the use of subcontractors by any party.

*Commentary*

*22.86.11.1 Employee agreements*

A customer *might* not need for a supplier's employees to be bound by written agreements to cause the employee's work product to be owned by the customer (at least under U.S. law). See generally this annotated flowchart prepared some years back by the author.

*22.86.11.2 Subcontractor agreements*

On the other hand a *subcontractor* of a contractor likely would indeed need to sign such an agreement in order to transfer *ownership* to the contractor's customer; the customer *might* be able to claim an implied license to use and further-develop the deliverable — but the associated litigation would likely be an expensive headache. See, e.g.: Graham v. James, 144 F.3d 229 (2d Cir. 1998) (software created by contractor was not work made for hire but *was* orally licensed nonexclusively); Effects Assoc., Inc. v. Cohen, 908 F.2d 555, 557 (9th Cir. 1990) (affirming summary judgment: copyright had not been orally transferred to alleged infringer, but actual copyright owner had implicitly granted a nonexclusive license to defendant); Latour v. Columbia University, 12 F. Supp. 3d 658, 662 (S.D.N.Y. 2014) (granting summary judgment in favor of defendant university, which had an implied license to use material developed by former interim faculty member); Numbers Licensing LLC v. bVisual USA Inc., 643 F. Supp. 2d 1245, 1252-54 (E.D. Wash. 2009) (denying motion for preliminary injunction; while software in dispute had been created by plaintiff as outside contractor and thus was not work made for hire, defendant had implied license); Logicom Inclusive, Inc. v. W.P. Stewart & Co., No. 04 Civ. 0604, slip op., part IV.A.3 (S.D.N.Y. Aug. 9, 2004) (denying motion to dismiss; defendant, a longtime customer of plaintiff software development company, did not have implied license to use software after defendant terminated contract).

### 22.86.12 Assignment-document signatures required

a. *Written transfers:* When a party (a "former owner") is required to "*assign*" intellectual property in or under the Contract to another party (the "new owner"):

the former owner must permanently and irrevocably transfer all ownership of the IP,

in writing — see also the documentation requirements in subdivision c —

to the new owner and the new owner's successors and assigns.

The written transfer of ownership must encompass, as applicable to the type of IP in question:

a. any and all patent applications for any portion of the specified IP, no matter when filed —

this includes, without limitation, all original, continuation, continuation-in-part, divisional, reissue, foreign-counterpart, or other patent applications;

b. any and all patents issuing on each patent application described in subdivision b.1;

c. the right to claim priority in, to, or from any patent application described in subdivision a or any patent described in subdivision b.2;

d. any and all registrations for, and any and all applications to register, the copyright or trademark rights (if any) in the specified IP;

e. any other intellectual property rights, of whatever nature, in the specified IP,

together with any applications for, or issued registrations for, the same; and

f. the right to recover, and to bring proceedings to recover, damages and any other monetary awards,

and/or to obtain other remedies,

in respect of infringement or misappropriation of any item listed in any of subdivisions b.1 through b.5,

whether the infringement or misappropriation was committed before or after the date of the transfer of ownership.

b. *Additional documents:* Whenever reasonably requested by the new- or existing owner from time to time,

> the former owner is to cause documents to be signed and delivered to the new owner to establish and/or confirm the new owner's rights in the specified IP.
>
> Such documents might include, without limitation: patent applications; copyright- or trademark registration applications; and assignment documents.

c. *Documentation expenses:* As between the former owner and the new owner, the new owner must pay for preparing and filing any such documents *unless* otherwise agreed in writing.

d. *No additional compensation:* In case of doubt: The former owner will not be entitled to additional compensation for doing the things required by this [NONE], over and above any compensation clearly stated in the Contract.

*Commentary*

Subdivision b: The "cause documents to be signed" language recognizes that a corporate party might have to cause its employee inventors and authors to sign individual assignments of rights.

## Clause 22.87 Intellectual Property Rights Challenges

*Commentary*

Background: It's not unheard of for a *licensee* of intellectual property to be faced with a legal- or business challenge to the licensed IP rights. When that happens, the *licensor* will generally want to control the response to the challenge, because the licensor will generally have more "skin in the game."

*Hypothetical example:* WhizBang, Inc., licenses ABC Corporation to use the WHIZBANG trademark in return for royalty payments. A competitor, BigBang Co., begins using the WHIZBANG trademark without authorization from WhizBang the com-

pany. WhizBang's licensee, ABC, is unhappy that it (ABC) must pay royalties to WhizBang for use of the trademark while BigBang doesn't; in that scenario, *WhizBang* will likely want to maintain control over the response to BigBang's infringement.

This Clause addresses the type of scenario summarized above. It draws on ideas found in the trademark license agreement form of The University of Texas at Austin (the present author's alma mater), at https://tinyurl.com/UTTrademarkLicense, discussed in more detail in the introductory commentary to [PH].

### 22.87.1 Types of "Challenge" covered by this Clause

a. This Clause will apply if a third party engages in any of the following activities — each, a "*Challenge*" — in respect of one or more intellectual-property rights (see the definition in Clause 22.85.2) (each, an "*Owner IP Right*"), that are owned or otherwise assertable by a party ("*Owner*"):

1. the third party putatively infringes the Owner IP Right; and/or
2. the third party disputes,

    in any judicial, administrative, or other forum, anywhere in the world,

    the validity and/or enforceability of the Owner IP Right.

b. The term "Challenge" in subdivision a includes, without limitation, the filing and/or maintaining, by the third party, of one or more of the following actions, in any forum anywhere in the world:

1. a pre-grant opposition to an application for the Owner IP Right —

    for example, an opposition to an application for a patent or for a trademark registration;

2. an affirmative defense or counterclaim of invalidity or unenforceability of the Owner IP Right;
3. a petition for an inter partes review of a patent, and/or
4. a petition to cancel a trademark- or copyright registration.

### 22.87.2 Other parties' obligations

If any Challenge to Owner's IP Rights comes to the attention of any other party to the Contract ("*Other Party*"), then Other Party must:

1. promptly so advise Owner in writing;

2. provide Owner (and Owner's counsel) with reasonable information and cooperation concerning the Challenge,

on an ongoing basis; and

3. not take any action concerning the Challenge without first getting Owner's written approval.

### 22.87.3 Owner's authority in the Challenge

It will be entirely up to Owner,

in Owner's sole discretion (see the definition in Clause 22.49),

to decide what action(s) to take, if any, to investigate and deal with the Challenge to Owner's IP Rights,

except to the extent, if any, that the Contract provides otherwise.

### 22.87.4 Confidentiality rules

In any Challenge to Owner's IP Rights,

one or both of Owner and Other Party may designate information in its posssession as Confidential Information,

in which case Tango Clause 22.34 - Confidential Information will govern.

### 22.87.5 Owner responsibility for costs of Challenge

a. As between Owner and Other Party, Owner will bear all costs (in the sense of Owner's attorney fees and court costs only)

of any judicial, arbitration, or administrative proceeding,

at any level (e.g., trial or appeal),

in which the Challenge to Owner's IP Rights is to be decided.

b. Other Party is not obligated to fund or reimburse any Owner expense in respect of the Challenge *unless* the Contract clearly says otherwise.

### 22.87.6 Entitlement to monetary recoveries

As between Owner and Other Party, Owner will be entitled to any monetary awards,

> for example (see the definition in Clause 22.59), damages, profits, costs, and/or attorney fees,
>
> made against a third party in any proceeding concerning the Challenge to Owner's IP Rights.

*Commentary*

In some agreements, Owner and Other Party might agree to divide monetary recoveries among them. That might be especially true if *Other Party* were to fund the costs of responding to the Challenge, in which case the parties might agree that:

- a high percentage of the recovery would go to Other Party until Other Party had recouped its out-of-pocket expenses; and
- the balance of the recovery is somehow split between Owner and Other Party.

## Clause 22.88 Invoicing

*See also Tango Clause 22.120 - Payment Terms.*

### 22.88.1 Applicability

Any party desiring payment under the Contract must submit an invoice to the paying party in accordance with this Clause unless otherwise agreed.

*Commentary*

Invoices are a familiar part of business: A *paying* party will almost invariably want to receive an invoice before paying an amount alleged to be due.

(Paying parties might even be legally required to do so as part of their internal financial controls to help detect and prevent fraud.)

And invoices don't benefit just the paying party: A *payee* will generally want to use its invoices (which typically have serial numbers or other identifiers) to help the paying party keep track of:

- which invoices have been paid, and
- which invoices are past due and might need follow-up with the paying parties.

Exception: If a contract involves a large, one-time payment, the paying party might not find it necessary to get an invoice. (This can be documented in the contract if desired.) That's because in those circumstances, an invoice might not be necessary for the paying party's internal controls.

### 22.88.2 Itemized information required

Each invoice must itemize, at a minimum, any sales taxes, shipping charges, and insurance charges that are being billed (if any).

*Commentary*

Customers often want their suppliers' invoices to itemize specific amounts — typically: sales taxes; shipping charges; and insurance — to help with the customers' accounting and internal controls. In some cases, a customer might want its suppliers' invoices to include additional information, such as: • the customer's purchase-order number; • a supplier identification code assigned by the customer; • a contract identifier assigned by the customer; • the supplier's or customer's part numbers; • quantities; • units of measure; • hours billed; • unit- and total prices; • export- and safety-related information.

This might be especially true if the customer might want to exercise audit rights, if the customer has such rights under the Contract (see [NONE]).

For some detailed customer invoicing requirements, see: • section 13 of a Honeywell purchase order, archived at https://perma.cc/84BS-KYXB; and • Walmart's required information, at https://corporate.walmart.com/suppliers/spm-support (scroll down)

**Caution:** For obvious security reasons, if an invoice is to be sent by email, it's not a great idea to include the payee's bank wire-transfer information.

### 22.88.3 Invoice submission methods

a. The Contract:

1. may specify one or more invoicing methods that may — or must — be used; or

2. may provide that the paying party may, from time to time, specify an invoicing method.

b. IF: The Contract does not specify a mandatory invoicing method; THEN: The invoicing party may use any reasonable method.

*Commentary*

A paying party might want its suppliers to submit invoices via a particular electronic invoicing system.

A prospective payee, of course, will usually be motivated to go along with any (reasonable) invoice-submission request by the paying party.

**Caution:** It's not a great idea to lock down the details of the invoice-submission procedure in the body of the Contract itself, because then a change to the invoicing procedure would arguably require an amendment to the Contract.

**Pro tip:** If an invoice will be submitted in hard copy, it'd be a smart idea for the invoicing party to confirm the *current* invoicing address. Otherwise, the invoice could get misrouted or mislaid within the paying party's mail-circulation system.

### 22.88.4 Payment-method reminder

IF: The Contract specifies that one or more particular payment methods may — or must — be used; THEN: Each invoice should include a suitable reminder (but this is not mandatory).

*Commentary*

Sometimes an invoicing party prefers to be paid in a particular way. (See Section 22.120.3: for a discussion of possible methods.) A collegial invoicing party would let the paying party know ahead of time about the invoicing party's payment preference.

### 22.88.5 Timing of invoices

a. The Contract may specify a schedule for sending invoices.

b. IF: The Contract does not specify an invoicing schedule; THEN: An invoicing party must not send an invoice until everything is done that the Contract requires the invoicing party to do — for example, when all required deliveries have been made or all required services have been completed.

*Commentary*

It's fairly typical for suppliers to send invoices when they finish their performance under the Contract, e.g., upon delivery of ordered goods or completion of services performance.

BUT: In construction- and other services agreements, the service provider will often want to be paid as soon as possible *after particular phases of the work are completed*, as opposed to waiting to be paid until the work is 100% complete. In that situation, the parties' agreement will typically state when interim invoices are to be sent, e.g., • every month or quarter, and/or • when specified performance targets are reached.

### 22.88.6 Invoice-submission deadlines

The Contract may state when invoices must be submitted, and/or that late-submitted invoices need not be paid, but any such statement must be unambiguous.

*Commentary*

#### *22.88.6.1 Late invoices can cause severe accounting headaches*

An excessively-late invoice could cause serious accounting problems for a paying party; for that reason, it's not unknown for a customer to say (for example, in the boilerplate terms and conditions of its purchase-order form) *we must receive your invoices no later than X days after the end of our fiscal quarter — and we need not pay the invoice if we receive it after that*.

Such a customer might be concerned about having to "restate" financial results for the relevant fiscal period, which could happen if a late invoice were to turn out to materially alter those results. And for a public company, a restatement of financial results is a Very Bad Thing; it can lead to a sharp drop in the company's stock price, resulting from diminished investor confidence in the company's accounting practices. See generally Investopedia, Restatement.

Here's an indirect example of how late-submitted invoices could require a restatement of financial results:

- In 2006, Calgon Carbon Corporation, a public company (NYSE), learned that some $1.4 million in outside-counsel invoices had not been properly recorded as expenses for the relevant financial periods.
- The law-firm invoices were not recorded as expenses because the company's general counsel, i.e., the company's chief in-house lawyer, had not processed the invoices. (The author recalls reading, but can't find the article, to the effect

that the general counsel had stuck the invoices in his desk drawer instead of submitting them to the accounting department as he should have done.)

- The law firm's invoices were significant in amount; as a result, when the invoiced amounts were properly recorded as expenses for the relevant periods, the company had to restate its financial results for three different quarterly reporting periods. And the day after the company announced its restated numbers, the company's share price dropped by more than 24%, on something like eight to ten times the normal daily trading volume.

Epilogue: On the day that Calgon Carbon announced its restatement, the company's general counsel left the company and his employment agreement was terminated. Was he fired? That's certainly a good guess. See an SEC filing about the forthcoming restatement (Mar. 27, 2006); another SEC filing about the general counsel's termination on the same day as the restatement filing (Mar. 31, 2006); and an article, Calgon Carbon releases lawyer, reports more losses (TribLive.com Mar. 28, 2006); see also Rick Stouffer, Calgon Carbon profits fall (TribLive.com Mar. 29, 2006). The historical share price can be found at Investing.com.

#### *22.88.6.2 Model invoice-deadline language*

A "death penalty" invoice-submission deadline should be clearly agreed to in advance. So, drafters could include language such as the following in the Contract *to rule it out*:

> a. Unless the Contract unambiguously states otherwise, a paying party must pay an invoice even if the invoice is submitted after an agreed deadline for doing so.
>
> b. A reasonable delay in payment will not be a breach, however, if the payment delay was made necessary by the invoice delay.

Or alternatively, to allow the paying party to ignore a late-submitted invoice:

> If an invoice is received after an agreed, relevant, invoicing deadline, then it will be up to the payer's sole and unfettered discretion (see the definition in Clause 22.49) to decide when — and whether — to pay the invoice.

### 22.88.7 Language(s) of invoice

Each invoice is to be written: (i) in the language in which the Contract is written; and (ii) if required by law or by the Contract: in the official language of the originating country and/or of the destination country.

*Commentary*

Local tax law might require invoices to be written in the local language to facilitate tax audits — but obviously it's a good idea also to write an invoice in a language that the payer will understand. (For that reason, bi- or even trilingual invoices are sometimes used.)

## Clause 22.89 JURY TRIAL WAIVER

a. To the greatest extent not prohibited by law, each party VOLUNTARILY WAIVES the right to trial by jury for all Agreement-Related Disputes (see the definition in Clause 22.3).

b. Each waiving party certifies —

1. that no representative, agent or attorney of any other party has represented, expressly or otherwise, that the other party would not seek to enforce the waiver, and

2. that the waiving party is not relying and will not rely on any such representation if made.

c. Each waiving party also acknowledges, with the effect stated in [NONE]:

1. that each other party will rely on the waiving party's certification in subdivision b in deciding whether or not to enter into the Contract on the economic- and other terms stated in it; and

2. that such reliance by the other party will be reasonable.

Commentary

### 22.89.1 Purpose

Businesses often want to avoid jury trials of disputes — typically, this is because they don't want the expense and uncertainty of being judged by a semi-random group of citizens who might or might not be familiar with such matters.

### 22.89.2 Caution: *Pre-dispute* waivers of jury trial might be unenforceable

• California: *See* Grafton Partners, L.P. v. Superior Court, 36 Cal. 4th 944, 32 Cal. Rptr. 3d 5, 116 P.3d 479 (2005) (state constitution prohibits advance waivers of jury trial); Handoush v. Lease Finance Group, LLC, 41 Cal. App. 5th 729 (2019) (California prohibition of pre-dispute jury trial waiver overrode parties' contractual choice of New York forum and law); Rincon EV Realty LLC v. CP III Rincon Towers, Inc., 8 Cal. App. 5th 1, 213 Cal. Rptr. 3d 410 (2017) (California prohibition of pre-dispute jury trial waiver overrode parties' contractual choice of New York law); *accord*, In re County of Orange (v. Tata Consultancy Services Ltd.), 784 F.3d 520 (9th Cir. 2015) (adopting *Grafton Partners* rule for federal diversity cases).

• Georgia: *See* Bank South, N.A. v. Howard, 264 Ga. 339, 444 S.E.2d 799 (1994).

### 22.89.3 Subdivisions b and c: No-reliance certification

See the commentary to Tango Clause 22.133 - Reliance Waiver.

## Clause 22.90 Knowledge Definition

### 22.90.1 Actual knowledge required

Knowledge refers to actual knowledge; related words such as *knows*, *knowingly*, and like words have corresponding meanings.

*Commentary*

This section is adapted *almost* verbatim from subdivision b of UCC 1-202.

Other subdivisions of UCC 1-202 are *not* incorporated into this definition; some of those other subdivisions define "notice" and specify default rules for when *an organization* has knowledge or notice of a fact, but those default rules might conflict with the notice provisions of a contract.

Note: Merger- and acquisition (M&A) agreements often contain definitions of knowledge that are much more elaborate than this one. (More-elaborate definitions seem to be less common in contracts for commercial transactions.)

### 22.90.2 Organizational knowledge

An organization is *not* considered to have knowledge of something unless —

the thing in question is shown to have been known, at the relevant time,

by an individual who, at that time, had management responsibility concerning the associated subject matter.

*Commentary*

This section is intended to avoid imputing knowledge of something to an entire organization just because *someone* in the organization (supposedly) knew it.

### 22.90.3 No implication of inquiry

IF: A representation (see the definition in Clause 22.134) or other statement about a particular matter is qualified by a term such as "to our knowledge" or "so far as we know," or words of similar effect,

THEN: The statement is not intended to imply that the party making the statement made any particular inquiry about the matter, *unless* the statement clearly indicates otherwise.

*Commentary*

In contrast to UCC 1-202, this subdivision refrains from imposing a duty of inquiry; a party desiring to do so should specify it explicitly.

## Clause 22.91 Labor-Law Rights

### 22.91.1 Party intent

The parties do not intend for anything in the Contract to restrict the ability of a party to exercise any legally protected and non-waivable right:

1. to engage in collective action, for example under the U.S. National Labor Relations Act ("*NLRA*"); and/or

2. to file a charge or other claim with a governmental authority, for example, the U.S. National Labor Relations Board ("*NLRB*") or the U.S. Equal Employment Opportunity Commission ("*EEOC*").

*Commentary*

The (U.S.) National Labor Relations Board has been hostile to contractual confidentiality restrictions that purport to limit employees' discussions of wages and working conditions.

See generally, e.g., Nat'l Labor Rel. Bd. v. Long Island Assoc. for AIDS Care, 870 F.3d 82, 88-89 (2d Cir 2017) (affirming NLRB ruling).

More recently, however, Trump appointees to the NLRB appear to be more open to employer-employee agreements that favor the employer.

See, e.g., Stephen M. Swirsky, NLRB Board Members Signal Intention to Reconsider Board Law on Confidentiality of Settlement Agreements and to Modify the Board's Blocking Charge "Rule" (NatLawReview.com Jan. 5, 2018).

It remains to be seen whether the incoming Biden administration will make any changes in this regard.

### 22.91.2 No implied concession of statutory applicability

In case of doubt, by agreeing to this Clause, the parties are not implicitly agreeing:

a. that an employment relationship exists between the parties; nor

b. that the NLRA or other legislation applies; nor

c. that the NLRB, EEOC, or other authority, has jurisdiction.

*Commentary*

This section is a roadblock clause intended to forestall contrary arguments by "creative" litigation counsel.

# Clause 22.92 Language Capability

## 22.92.1 Definition: *Contract Language*

The term "*Contract Language*" refers to the language in which the body of the Contract is principally written.

## 22.92.2 Mandatory written uses of Contract Language

a. The Contract Language must be used for the following:

1. all any notices under the Contract; and

2. all service of legal process in any dispute arising out of or relating to the Contract or any transaction or relationship resulting from it,

except as provided in subdivision b.

b. IF: Applicable law requires that service of process be made in a different language; THEN: A translation into the Contract Language of each other-language document served is to be served with the other-language document.

*Commentary*

### *22.92.2.1 Business context*

In a LinkedIn discussion (membership required), the following points were suggested:

• English is the global *lingua franca*.

• The choice of language for drafting a contract should take into account the jurisdiction (or jurisdictions) in which the contract is likely to be enforced — even with translations, it can be expensive, burdensome, and risky to ask a court to interpret and apply a contract written in a language not its own.

• It *might* be possible to "write around" legal requirements that contracts be written in a local language by requiring binding arbitration in the desired language. (It would make sense to include, in the contract, a translation of the arbitration provision into the local language.)

• A party acting in bad faith might try to claim that it misunderstood a term in a foreign language.

• In some cases, the body of the Contract might be written in multiple languages, or the Contract might have attachments in different languages.

**Caution:** Drafters of transnational contracts will want to check local law (and possibly engage local counsel) to see whether the law in a potentially-relevant jurisdiction requires contracts to be in the local language. EXAMPLE: • Indonesia • Québec • China.

#### *22.92.2.2 Subdivision a.1: Language for notices*

Requiring notices and service of process to be in the Contract Language could be important: A U.S. retailer found itself losing an arbitration in China — and having a sizable damages award entered against it — because the notice of arbitration was written in Chinese, and the U.S. retailer did not get the notice translated in time to avoid adverse consequences under the arbitration rules. (The U.S. retailer in that case managed to dodge the bullet: A U.S. court refused to enforce the arbitration award against the retailer, on grounds that a different agreement controlled, under which the arbitration notice was required to be in English, not Chinese.) See CEEG (Shanghai) Solar Science & Tech. Co. v. LUMOS LLC, 829 F.3d 1201 (10th Cir. 2016), *affirming* No. 14-cv-03118 (D. Colo. May 29, 2015). As a former student of the author's once said: That's a conversation we don't want to have.

### 22.92.3 Permissive written uses of Contract Language

The Contract Language may be used for any other written communication in connection with the Contract.

### 22.92.4 Required capability of oral use of Contract Language

a. Each party is to maintain the capability of conducting routine business orally in the Contract Language,

for example (see the definition in Clause 22.59), in person or by telephone,

whether through party personnel who can speak the Contract Language,

or via translators engaged at the party's expense.

b. Subdivision a does not limit any party's right to communicate orally in any other language,

when agreed to by the individuals involved,

and not a hindrance to the purpose of the Contract.

*Commentary*

This provision tries to balance: • the parties' interest in making sure they can communicate orally, against • the possible threat of legal action from employees claiming discrimination on the basis of national origin. See, e.g., U.S. Department of Labor, Office of the Assistant Secretary for Administration & Management, What do I need to know about… English-Only Rules (DOL.gov, undated).

### 22.92.5 Effect of translations of the Contract

a. Any translation of the Contract or any related document is for convenient reference only and not binding on any party.

b. The version of the Contract or related document in the Contract Language is to take precedence in case of discrepancy.

*Commentary*

Drafters dealing with multi-lingual appendixes, exhibits, etc., will want to consider this provision carefully.

In a LinkedIn discussion (membership required), the following points were suggested:

- Translations can be iffy, because specialized words and phrases, such as *fraud* and *gross negligence*, conceivably might be translated into other languages in ways that have subtly different meanings than the original.
- An expensive but sometimes-worthwhile approach is to negotiate a contract in one language; have the final draft translated into another desired language; and then have the translation retranslated back into the original language.

## Clause 22.93 Lawyer Involvement

a. *Lawyer contact information:* IF: Either party asks another party for contact information for the other party's legal counsel in connection

with a particular matter relating to the Contract; THEN: The other party must promptly provide that information to the asking party.

b. *In-house counsel:* If the other party has in-house counsel, it is not acceptable for the other party to respond to the asking party that the other party's counsel are not involved, nor that the other party does not want to get its counsel involved.

c. *Consent to copying of non-lawyers:* Legal-ethics rules might prohibit counsel for one party ("Party A") from copying non-lawyer personnel of another party ("Party B") without the consent of B's counsel — so to save time, B is to instruct its counsel to give such consent unless good reason exists for doing otherwise.

*Commentary*

*22.93.0.1 Purpose*

Sometimes parties' business people can get stuck in a disagreement that might be resolved quickly or even immediately by getting the parties' counsel involved. But sometimes a party's *business* person might refuse to get the party's *lawyers* involved; this could be due to embarrassment or to a desire to avoid spending money on outside counsel. This Clause gives the other party a bit of leverage in such situations, because the other party can tell the refusing party's business person, "you do realize that by refusing to get your lawyer involved, you're in breach of contract for that alone, right?"

*22.93.0.2 Subdivision c: Consent to copying non-lawyers*

This subdivision addresses a type of legal-ethics rule that's common in the U.S.; see, e.g., ABA Model Rules of Professional Conduct, Rule 4.2, *Communication with Person Represented by Counsel*: "In representing a client, a lawyer *shall not communicate* about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, *unless* the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order." (Emphasis added.) This prohibition can be an irritant to all concerned, because it putatively requires Party A's lawyers to send emails only Party B's *lawyers* and asking those lawyers to forward the email to Party B's business people, instead of just "cc'ing" Party B's business people as normal humans would do.

# Clause 22.94 Lead Representatives

## 22.94.1 Applicability; parties

a. This Clause will apply if, under the Contract, one or more parties (each, a "*designating party*"), may (or must) designate a lead representative (each, a "*Lead Rep*") for purposes of the Contract either as an absolute requirement or if requested by another party.

b. In case of doubt, neither party is required to designate a Lead Rep unless the Contract clearly says otherwise.

*Commentary*

This Clause can be useful for contracts involving complex operations.

## 22.94.2 Designation of Lead Rep(s)

a. Any party that wishes to designate a Lead Rep for purposes of this Clause may do so in a written communication to each other relevant party.

b. A designating party may designate multiple Lead Reps:

for the same purpose,

possibly for different time periods,

and/or for different purposes.

*Commentary*

Subdivision b: A designating party, which we'll call "ABC Corp.," might designate "Alice" as ABC's Lead Rep for the day shift; "Allen" for overnight; and "Amy" for weekends.

Or, ABC Corp. might designate Alice as ABC's Lead Rep for engineering matters; Allen for personnel matters; and Amy for financial matters.

## 22.94.3 Changes to Lead Rep designations

a. At any time, a designating party may "un-designate" one or more of its Lead Reps, doing so in any manner that the designating party is allowed or required to make such a designation.

b. A designating party's un-designation of a Lead Rep will not change the effect of that Lead Rep's prior actions and communications in that role.

c. IF: Un-designating a Lead Rep means that the designating party no longer has a Lead Rep in a given category;

AND The Contract requires the designating party to have a Lead Rep for that category;

THEN: The designating party must promptly designate a replacement Lead Rep for that category.

*Commentary*

Subdivision b precludes a designating party from "moving the goalposts" on the other party if the designating party's Lead Rep says or does something that the designating party comes to regret.

### 22.94.4 Limitations on Lead Reps' authority

a. A designating party may place written limits on a Lead Rep's authority:

1. in the designating party's initial designation of that Lead Rep; and/or

2. in a subsequent notice (see the definition in Clause 22.112) to the other party.

b. A communication by a Lead Rep outside the stated limits of that Lead Rep's authority will not be binding on the designating party,

and the other party will not be entitled to rely on that communication.

*Commentary*

Subdivision a: As an example, suppose that ABC Corp. designates Alice as its Lead Rep. The designation might state that Alice is not authorized to make commitments on behalf of ABC Corp. that would cost more than X dollars, in much the same way that some organizations, when spending money, require two authorized signatures on checks for amounts exceeding X dollars.

(**Caution:** It could be burdensome for the other party to have to keep track of limitations on Lead Reps' authority.)

Subdivision b uses the phrase "the other party *will not be entitled* to rely on" on a particular communication, because the phrase "the other party *may not rely* on" the communication could be misinterpreted as "the other party *might not* rely on" the communication. See also Tango Clause 22.103 - May and May Not Definition (*may* is for permission, *might* is for possibility).

### 22.94.5 Binding effect of Lead Reps' communications

a. The other party is entitled to rely on any communication from a Lead Rep as being authorized by, and binding on, the designating party, regardless whether the communication is oral, written, or in some other manner, *unless* under the circumstances such reliance would clearly be unreasonable.

b. Two non-exclusive examples of *unreasonable* reliance on a Lead Rep's communication might be as follows:

1. the communication exceeds the Lead Rep's authority as clearly limited in the designating party's written designation of the Lead Rep; and/or

2. the Lead Rep's communication itself counsels caution.

*(See also the written-summary provision in [NONE].)*

*Commentary*

Subdivision a is intended to forestall game-playing by either party, while still providing reasonable flexibility for party communications.

Subdivision b.2: One example of a "counsels caution" communication might be along the lines of, "this is what we *think* is going on here, but we're not sure."

### 22.94.6 Other party communications not binding

a. This section applies if another representative of a party that has designated a Lead Rep —

1. makes a request of another party; and/or

2. issues an instruction or update to another party,

but that other representative has *not* been designated as a Lead Rep of the designating party (in the relevant area, if applicable).

b. When subdivision a applies:

1. no other party is entitled to rely on the request, instruction, or update from the other representative of the designating party as purportedly being from the designating party;

2. no other party need comply with the request or instruction; and

3. if another party does elect to comply with the request or instruction, then that other party does so at its own risk and expense.

*Commentary*

Subdivision b – nonbinding communications from other representatives: This provision addresses one of the major causes of "troubled" contracts, which is that is unauthorized people can make change requests that can lead to cost overruns and delays. See, e.g., Steve Olsen, Troubled contracts – why missing these steps may trip you up (IACCM.com 2015).

BUT: In some cases, a party might want to be free to rely on any communication by any representative of the other party, under apparent-authority principles, instead of being obligated to pay attention only to Lead-Rep communications.

### 22.94.7 Binding written summaries

a. A written summary *by any party* ("*Party A*") of an oral communication from *any party's* Lead Rep will be binding on *any other party ("/Party B*"), *unless* Party B objects to the the summary in a writing that is received or refused by Party A (or that is undeliverable after reasonable delivery attempts) within a reasonable time after Party B receives the summary.

b. An *oral* communication from a Lead Rep that is *not* summarized in writing as stated in subdivision a will not be binding on the party that designated the Lead Rep, and no other party may rely on that communication, *unless* the other party can prove both the fact and the content of the communication by clear and convincing evidence (see the definition in Clause 22.30).

*Commentary*

Subdivision a sets out a flexible procedure for leaving a paper trail of parties' oral discussions; the procedure essentially codifies what courts would likely accept as corroborating evidence of the contents of such discussions.

(Subdivision b bows to the reality that parties likely will not always reduce their important oral communications to writing, so the subdivision provides some structure to the parties' dealings when that happens.)

## Clause 22.95 Legal Compliance

a. Each specified party must defend each other party, in accordance with Tango Clause 22.46 - Defense of Third-Party Claims, from any third-party claim arising from any violation of law by the first party in connection with the first party's activities under the Contract.

b. In case of doubt, this Clause does not require a party to completely *indemnify* (see the definition in Clause 22.78) other parties from losses arising from the first party's legal violations,

> but only to *defend* against third-party claims, and pay any resulting monetary awards, as stated in [NONE].

### Commentary

#### 22.95.1 Why no express *indemnity* obligation

Some contracts include not only *defense* obligations like that of this Clause, but also express *indemnity* obligations. But that might not be needed: Courts have held that a party's failure to comply with a law, *when required by contract*, could constitute a breach of the contract even if the law itself does not create a private right of action. See, e.g., Trone Health Services, Inc. v. Express Scripts Holding Co. 974 F.3d 845, 851-52 & n.4 (8th Cir. 2020) (citing cases, but holding that, for other reasons, plaintiffs had not stated a claim for relief); Smith v. JPMorgan Chase Bank, NA, No. 12-40816, slip op., text accompanying n.2, 519 Fed. Appx. 861, 864 (5th Cir. Mar. 22, 2013) (affirming summary judgment in favor of bank) (citing collection of cases in Franklin v. BAC Home Loans Servicing, LP, No. 3:10-CV-1174-M, slip op. at n.14 (N.D. Tex. Jan. 26, 2011) (Lynn, J., partially granting motion to dismiss)).

(As a general rule of thumb: The more that a drafter includes express indemnity obligations in a contract, the longer the other side's legal review will take, and the longer it will take to get the final agreed document to signature.)

#### 22.95.2 Indemnity for foreseeable losses only?

If a prospective protected party did want to negotiate an express *indemnity* obligation as well, then the *obligated* party should consider trying to limit the obligation to *foreseeable* losses, because it's not entirely clear that such a limitation would otherwise apply. See generally Glenn D. West, Consequential Damages Redux …, 70 Bus. Lawyer 971, 998 (Weil.com 2015) ("VI. Overlaying the Concept of Indemnification for Losses on the Contract Damages Regime"), archived at https://perma.cc/D2HC-Z5XD.

#### 22.95.3 Caution: Vicarious liability anyway?

Suppose that Provider and Customer enter into a contract for Provider to perform services, and then Provider fails to pay its employees for doing the work in question. In some jurisdictions, *Customer* might be liable to Provider's employees for their unpaid wages, as discussed in the extended commentary at Section 21.15.4: .

## Clause 22.96 Legal Power Representation

By entering into the Contract,

each party represents (see the definition in Clause 22.134),

to each other party,

that the representing party has the legal power to enter into and perform its obligations under the Contract,

including, without limitation, making any required grant of rights and conveying any property, as applicable,

without obtaining additional approval from any individual or organization,

*unless* unambiguously stated otherwise in the Contract.

*Commentary*

An organization's legal power to take certain actions might require approval by the organization's shareholders (if a corporation), members (if an LLC), limited partners (if a limited partnership), etc.

Some strategically-important types of agreement typically include more-detailed "reps and warranties" of this kind; see, e.g., the merger agreement between United Airlines and Continental Airlines, at

https://www.sec.gov/Archives/edgar/data/100517/000095015710000587/ex2-1.htm.

## Clause 22.97 Letters of Intent

### 22.97.1 Introduction; applicability

This Clause applies if the Contract unambiguously indicates that it is to be a "letter of intent", also referred to here as an "LOI."

*Commentary*

When it comes to letters of intent, business people can be **like teenagers and sex**: You tell them not to do it, and you warn them of the dangers, but you won't always be there to chaperone them; and let's face it, in the throes of desire they might well forget — or dismiss — your sound advice.

So unless you want to be stuck helping to deal with the consequences, it might be a good idea to try to make sure that your "teenagers" use "protection" if they ignore your advice and start messing around with LOIs.

The usual form of protection takes the form of various disclaimers of any intent to be bound, such as in this Clause.

For additional guidance about letters of intent, see generally Jennifer Jaskolka and Barbara Strnad *[sic]*, A Letter of Intent Should Not Spoil the Venture, ACC *[Association of Corporate Counsel]* Docket, Oct. 2020, at 42 (ACCDigitalDocket.com).

### 22.97.2 Background

The parties intend to discuss, or to continue discussing, a potential business arrangement (a potential "*Arrangement*");

they anticipate that they might eventually enter into a final, definitive written agreement (a "*Final Agreement*"):

that sets forth all final, material terms of the Arrangement,

and is signed and delivered by all relevant parties.

*Commentary*

The above explanation can help future readers — such as judges — to understand the business context.

### 22.97.3 Parties' intent

The parties are entering into the LOI with the following intent:

1. to make it clear that the parties have not yet agreed to all material terms of the potential Arrangement,

    and that they do not yet agree to be bound except as provided in the LOI;

2. to provide the parties with a convenient outline of the potential Arrangement as they are then currently contemplating it; and

3. to set out agreed ground rules for the parties' anticipated discussions about the potential Arrangement.

*Commentary*

The above section should help to clearly establish the parties' thinking for all concerned — because the consequences of entering into what one party *thinks* is a "nonbinding" letter of intent can be significant if a court later finds that the parties in fact intended to enter into a binding contract:

### 22.97.4 No exclusivity unless clearly stated

Except to the extent (if any) that the LOI expressly states otherwise, each party remains free, in that party's sole discretion (see the definition in Clause 22.49), to seek, discuss, negotiate, and/or enter into other arrangements, of any kind, with other parties —

> even if, as a result of such other discussions, etc., it would no longer be possible for one or more of the parties to enter into a Final Agreement.

*Commentary*

Suppose that *A* and *B* are negotiating a contract, and *C* comes along to offer *A* a better deal. In that situation, *B* might try to claim that *A* had *implicitly* agreed to negotiate *exclusively* with *B* for some period of time. This section tries to forestall such a claim.

Drafters can also consider:

- Tango Clause 22.60 - Exclusivity; and
- for M&A-type agreements: Tango Clause 22.109 - No-Shop.

### 22.97.5 Freedom to withdraw from discussions

Any party may withdraw from discussion of the potential Arrangement and negotiation (if any) of a Final Agreement,

> in the withdrawing party's sole discretion (see the definition in Clause 22.49),
>
> without obligation or liability of any kind, under any legal- or equitable theory, to any other party,
>
> until such time — if any — as the Final Agreement is signed and delivered by all parties.

*Commentary*

The above language seeks to block a party from claiming that a party to an LOI had an *implied* obligation to continue negotiating.

### 22.97.6 Limited binding LOI obligations

The parties intend for only the following terms in the LOI to be binding:

1. this Clause; and
2. any other terms in the LOI that the parties have clearly agreed in writing are to be binding, such as, if applicable:

> confidentiality;
>
> exclusivity; and/or
>
> no-shop.

*Commentary*

See also, for example:

- Tango Clause 22.34 - Confidential Information
- Tango Clause 22.60 - Exclusivity

- Tango Clause 22.109 - No-Shop

### 22.97.7 Importance of LOI

Each party acknowledges that without that party's agreement to this Clause, the other party would not go forward with discussions about the potential Arrangement.

*Commentary*

The above language has in mind that courts often emphashize parties' freedom of contract and pay attention to such declarations about the importance of particular provisions. See, e.g., SOLIDFX, LLC v. Jeppesen Sanderson, Inc., 841 F.3d 827, 837 (10th Cir. 2016) (vacating and remanding judgment on jury verdict); *after remand*, No. 18-1082, slip op. at 12-13 (10th Cir. Aug. 4, 2020) (unpublished; reiterating the point in affirming trial-court judgment in relevant part).

### 22.97.8 Final Agreement signature requirement

Neither party will be bound by any obligation or liability, nor entitled to any right, relating to the potential Arrangement,

unless and until the parties sign and deliver a Final Agreement,

except to the extent (if any) that the LOI clearly states otherwise,

no matter what other communications or actions might transpire concerning the potential Arrangement, in any form or medium and for any length of time, before the parties' formal entry into the Final Agreement,

and regardless whether an alleged obligation, liability, or right purportedly arises in contract; tort; strict liability; *quantum meruit*; quasi-contract; unjust enrichment; or otherwise.

*Commentary*

In at least some jurisdictions, the express requirement of a Final Agreement, and the disclaimer of binding effect of other communications, should be enough to keep prior written exchanges from being binding. For example, the Texas supreme court held that a trial court had correctly granted summary judgment that, as a matter of law, a particular email exchange did *not* create a binding agreement in view of a confidentiality agreement that contained a "No Obligation" clause. See Chalker Energy Partners III, LLC v. Le Norman Operating LLC, 595 S.W.3d 668, 670 (Tex. 2020) (reversing court of appeals).

And in the famous *Pennzoil v. Texaco* case, a Texas appeals court held that "[a]ny intent of *[Getty Oil and Pennzoil] not* to be bound before signing a formal document is not so clearly expressed in *[their]* press release to establish, as a matter of law, that there was no contract at that time." Texaco, Inc. v. Pennzoil Co., 729 S.W.2d 768, 790 (Tex. App.—Houston [1st Dist.] 1986, writ. ref'd n.r.e.).

### 22.97.9 Early start not binding

IF: A party begins taking action concerning the potential Arrangement before a Final Agreement has been fully signed and delivered; THEN:

1. The party taking action does so entirely at its own expense and risk, including but not limited to legal risk; and

2. No party may assert that such action constitutes or evidences:

    agreement to the Final Agreement, nor

    the formation of a partnership, joint venture, or similar type of relationship.

*Commentary*

It sometimes happens that when parties sign a letter of intent, their business people decide to "get going" before the lawyers finish the final, formal contract. The above language tries to forestall a particular type of finding: That a contract — or *a partnership* or other relationship — was formed, not by negotiation and a formal contract, as contemplated in the letter of intent, but instead by the parties' actions.

(This can be important because every first-year law student learns that (in the U.S.) an can be accepted *by performance* and thereby form a binding contract; see, e.g., UCC § 2-206. That presents an opportunity for a party to claim that this is what happened.)

Moreover, under state law a *partnership* can arise even without a contract. According to a Texas jury — whose $550–million verdict was subsequently overturned on appeal — two parties formed a *de facto* partnership, even though they had signed a letter agreement disclaiming any such intent, because (said the plaintiff and the jury) the parties had *behaved* as though they were partners. Fortunately for the defendant, the court of appeals and the state supreme court later held that the parties' freedom of contract allowed them to agree that they would *not* be subject to partnership obligations unless and until the prerequisites in their agreement had been met. See Energy Transfer Partners, L.P. v. Enterprise Products Partners, 593 S.W.3d 732 (Tex. 2020), *affirming* 529 S.W.3d 531 (Tex. App.—Dallas 2017).

### 22.97.10 No reliance

Each party agrees not to rely on the existence of this LOI, nor on any discussions between the parties concerning the potential Arrangement, as as an offer, agreement, or other commitment of any other party,

except to the minimum extent — if any — that the parties unambiguously agree otherwise in writing.

*Commentary*

In litigation or arbitration, a party to the dispute will sometimes claim that it relied to its detriment on some alleged statement or action by another party; the above language is intended to cut off such claims alleged to arise out of the discussions to which the LOI relates.

The above language is based on a suggestion in Jeff Brown and Jason Grinnell, What real estate parties should consider for letters of intent (JDSupra.com 2020).

## Clause 22.98 License (IP) Definition

a. In the context of intellectual property, the term "*license*" (verb), whether or not capitalized, refers to the granting, by a party ("*Owner*"), to one or more specified other parties (each, a "*Licensee*"), of a binding Owner commitment:

1. *not* to demand a monetary payment (other than agreed compensation) on account of Licensee's engaging in one or more activities, such as (without limitation) the making, using, selling, copying, distributing, or importing of something,

2. nor to seek to prohibit Licensee from engaging in any such activities,

3. in either case, on the purported grounds that such Licensee activities, or the product(s) of such activities, allegedly infringe one or more intellectual-property rights (see the definition in

Clause 22.85.2) that are owned or otherwise assertable by Owner.

b. In the same context, the term "*license*" (noun) refers to Owner's commitment described in subdivision a.

c. A license does not *authorize* Licensee to engage in such activities — Licensee might be subject to other restrictions, by law or otherwise;

instead, the license is only a commitment by Owner that Owner will not seek to exclude Licensee from engaging in such activities, nor seek monetary relief for Licensee's doing so (other than agreed compensation).

*Commentary*

This definition is intended in part for students and other newcomers to the IP field; it spells out in great detail what IP professionals implicitly know but seldom state explicitly.

## Clause 22.99 Limitation of Liability Effect

### 22.99.1 Applicability

This Clause applies to any term in the Contract that limits the liability of one or more parties, including without limitation by one or more of the following:

1. a disclaimer of one or more warranties; and/or

2. an exclusion of, and/or a cap on, one or more forms of monetary relief, including but not limited to an exclusion of consequential damages (see the definition in Clause 22.35).

### 22.99.2 Purpose

The limitation(s) of liability in the Contract are a fundamental part of the basis of the bargain between the parties; without such limitations,

one or more parties likely would not have entered into the Contract without changes to the economic terms stated in it.

*Commentary*

Drafters can be well-served by explaining, in the contract itself, why the parties are agreeing to limit liability. Such a payoff occurred for a defendant in a case where the contract in suit excluded recovery of lost profits but the jury awarded lost profits anyway. Vacating and remanding, the appeals court took specific note of a clause in the contract with language much like that of this section. See SOLIDFX, LLC v. Jeppesen Sanderson, Inc., 841 F.3d 827, 837 (10th Cir. 2016) (vacating and remanding judgment on jury verdict); *after remand*, No. 18-1082, slip op. at 12-13 (10th Cir. Aug. 4, 2020) (unpublished; reiterating the point in affirming trial-court judgment in relevant part).

### 22.99.3 Affected claims

Each limitation of liability set forth in the Contract is to apply to all claims for damages or other monetary relief whether alleged to arise: (i) in contract; (ii) in tort — including, without limitation, **negligence** and **gross negligence**; or (iii) under any other theory.

*Commentary*

This section is inspired by a partial failure of a limitation of liability in Facebook's terms of service: A court described that limitation of liability as a "showstopper" for a user's claims that Facebook had *breached a contract* following a data breach, but the limitation did **not** apply as to the user's claims for *negligence* because the limitation did not even mention negligence, "let alone unequivocally preclude liability for negligence." See Bass v. Facebook Inc., 394 F. Supp. 3d 1024, 1037, 1038 (N.D. Cal. 2019) (granting in part, but denying in part, Facebook's motion to dismiss).

Here, the terms *negligence* and *gross negligence* are in bold to make them conspicuous, in case the express-negligence rule in Texas and some other jurisdictions were to be held to apply (see the commentary to [NONE]).

### 22.99.4 If all stated remedies fail

Even if the Contract says that a harmed party is entitled only to certain specific types of remedy, and perhaps even to just one type of remedy, but those remedies did not solve the problem —

in legalese, those remedies "failed of their essential purpose" —

then any limitation(s) of liability in the Contract will remain in effect nonetheless.

*Commentary*

This section simply states how the law applies in many — but **not** all — U.S. jurisdictions. See Sanchelima Int'l, Inc. v. Walker Stainless Equipment Co., 920 F.3d 1141 (7th Cir. 2019), which discusses this point with citations; *but see* Biotronik A.G. v. Conor Medsystems Ireland, Ltd., 22 N.Y.3d 799, 11 N.E.3d 676, 988 N.Y.S.2d 527 (2014), which arguably would have led to a different result in the *Sanchelima Int'l* case for reasons not important here. **Caution:** In some states, this won't be the case; see, e.g., Prairie River Home Care, Inc. v. Procura, LLC, No. 17-5121 (D. Minn. Jul. 10, 2019).

### 22.99.5 "Even if ..."

A limitation of liability in the Contract will apply even if:

1. the harm resulting in the liability was clearly the fault of the liable party; and/or

2. the liable party and/or its agents knew (or had reason to know), at any time, that the harmed party had some special, out-of-the-ordinary vulnerability to being harmed.

*Commentary*

Subdivision 2 is a shout-out to the famous case of *Hadley v. Baxendale*, discussed in the commentary at Section 22.35: .

### 22.99.6 If legally unenforceable

A limitation of liability in the Contract will not apply if, and only to the extent that, under applicable law the limitation would be unenforceable in the circumstances.

*Commentary*

As one example, applicable law might provide that a limitation of liability is unenforceable when it comes to personal injury or death; see, e.g., UCC § 2-719(3), which provides in part: "... Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable ...."

## Clause 22.100 Limitation Period

a. This Clause applies if the Contract unambiguously states that a party, referred to here as a "*claimant*," has only a limited period of time (a "*limitation period*") in which to bring a claim against another party.

b. A limitation period in the Contract applies to all Agreement-Related Disputes (see the definition in Clause 22.3).

c. A claimant's failure to bring a claim before the end of an agreed limitation period WAIVES (see the definition in Clause 22.162) the claim.

Commentary

*Background note:* For purposes of the filing deadline under a statute of limitations, an action normally "accrues" — and thus the limitation countdown clock starts to run — at the time of the injury. Some jurisdictions, however, recognize "the discovery rule," which holds that, in certain circumstances, a claim accrues, and thus the limitation clock starts to run, when the plaintiff first had, or reasonably should have had, a suspicion of wrongdoing. See, e.g., Miller v. Bechtel Corp., 33 Cal. 3d 868, 663 P.2d 177 (1983) (affirming summary judgment on limitation grounds), *discussed in* Jolly v. Eli Lilly & Co., 44 Cal. 3d 1103, 1111, 751 P.2d 923 (1998) (affirming summary judgment on limitation grounds).

## Clause 22.101 Marketing *[to come]*

When this Clause is adopted in an agreement ("*the Contract*"), it applies as set forth in [BROKEN LINK: tango-which][BROKEN LINK: tango-which].

# Clause 22.102 Material & Material Breach Definition

## 22.102.1 *Material* definition

A thing is *material* (for example, material information) if a substantial likelihood exists that a reasonable person would consider the thing important in making a relevant decision.

*Commentary*

This definition is adapted from the opinion of the Supreme Court of the United States in a securities-law case.

See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

*Material* might be defined differently in other contexts. For example, Hawaii law contains a hair-trigger statutory definition of *material* in the context of residential-real-estate disclosures: "'Material fact' means any fact, defect, or condition, past or present, that would be *expected to measurably affect the value* to a reasonable person of the residential real property being offered for sale."

Hawaii Rev. Stat. 508D-1(3) (emphasis added); see generally Santiago v. Tanaka, 137 Haw. 137, 366 P.3d 612, 624 (2016).

**Caution:** A *summary* judgment on the issue of materiality (i.e., a court ruling without a trial) might be difficult to get. As the Texas supreme court explained: "Like other issues of fact, materiality may be decided as a matter of law *only if reasonable jurors could reach only one verdict*. If the evidence at trial would enable reasonable and fair-minded people to differ in their conclusions, *then jurors must be allowed to do so*."

Bartush-Schnitzius Foods Co. v. Cimco Refrig. Inc., 518 S.W.3d 432, 436 (Tex. 2017) (cleaned up; emphasis added).

## 22.102.2 *Material breach* definition

a. If the Contract states (in effect) that a certain type of breach will be material, then that statement is to be considered conclusive.

b. Otherwise, any determination whether a breach of the Contract was (or would be) material is to take into account the factors listed in the Restatement (Second) of Contracts § 241 (1981),

> considering the Contract as a whole, with no single factor necessarily being decisive.

#### *22.102.2.1 Why it matters whether a breach is "material"*

Perhaps the most-salient point about a *material* breach of contract is that in American jurisprudence, a material breach by one party excuses the other party* from continuing to perform its own obligations under the contract.

> See, e.g., Walmart, Inc., v. Cuker Interactive, LLC, 949 F.3d 1101, 1111-12 (8th Cir. 2020) (affirming judgment on jury verdict in favor of Cuker).

* *Note the use here of "the other party," as opposed to "the nonbreaching party," for reasons explained in the commentary to [NONE].)*

#### *22.102.2.2 Subdivision a: Agreed material breaches*

It's not uncommon for contracts to include such stipulations about what can constitute a material breach *Example:* A real-estate lease might state that the tenant's failure to pay rent when due, after notice and an opportunity to cure, is a material breach.

Courts will often give effect to such contractual stipulations about materiality. For example, in a major litigation over a computer-software development contract, the Indiana supreme court held that under that state's law, the contract's specification of standards of materiality took precedence over a Restatement-of-Contracts analysis (see the citation in subdivision b of this section): "when a contract sets forth a standard for assessing the materiality of a breach, that standard governs. Only in the absence of such a contract provision does the common law, including the Restatement, apply."

> Indiana v. IBM Corp., 51 N.E.3d 150, 153 (Ind. 2016).

#### *22.102.2.3 Subdivision b: "As a whole …."*

The "as a whole" language in subdivision b is modeled on section 16.3.1(1)(A) of the master service agreement in the *Indiana v. IBM* case, cited above. **But:** This language might well reduce the likelihood of getting summary judgment about the materiality or immateriality of a partiuclar breach.

### 22.102.3 Multiple non-material breaches

A history of multiple *non-material* breaches could *collectively* constitute a material breach of the Contract when considering that agreement as a whole; this is true:

whether the individual breaches are related or unrelated; and

whether or not one or more of the individual breaches is cured.

*Commentary*

At some point, a party might respond to a series of non-material breach by (figuratively) slapping the table and saying, "Enough is enough!" Language like this is found in some contracts. See, e.g., section 16.3.1(1)(c) of the master service agreement in Indiana v. IBM Corp., 51 N.E.3d 150, 155 (Ind. 2016).

As another example: Walmart found itself liable for breach of a contract with a digital marketing agency company that Walmart had hired to make a Walmart-related Web site software-development company for a fixed fee; the appeals court noted that:

> Walmart failed to make the second contract payment on time. It continually demanded that Cuker take on additional tasks and threatened to withhold payment for in-scope work if Cuker did not comply. … There is more than sufficient evidence in this record from which a reasonable jury could find that Walmart materially breached the contract and thereby excused Cuker's performance under the contract.

Walmart, Inc., v. Cuker Interactive, LLC, 949 F.3d 1101, 1111-12 (8th Cir. 2020) (affirming judgment on jury verdict in favor of Cuker).

## Clause 22.103 May and May Not Definition

a. The term *may* is permissive; if the Contract states that a party may take (or omit) an action, it means that the party has the right, but not the obligation, to do so, in its sole and unfettered discretion (see the definition in Clause 22.49), unless the Contract clearly states otherwise.

b. If the Contract states that a party *may not* take (or may not omit) an action, it means that the party is prohibited from doing so.

*Commentary*

This definition is intended to preclude a party from arguing that another party that "may" do X must exercise good faith, or be reasonable, or anything like that.

See generally Ken Adams, "May" Can Mean "Might," But I Sleep Well at Night Anyway (Adams-Drafting.com 2014).

## Clause 22.104 Midnight Definition

References to *midnight* on a stated day are to exactly midnight at the *end* of that day unless clearly specified otherwise.

*Commentary*

This definition of *midnight* is included because the term is ambiguous — as pointed out by the (U.S.) National Institute of Standards and Technology in a frequently-asked-questions (FAQ) document:

> 12 a.m. and 12 p.m. are ambiguous and should not be used. … 'a.m.' and 'p.m.' are abbreviations for "ante meridiem" and "post meridiem," which mean "before noon" and "after noon," respectively. Since noon is neither before noon nor after noon, a designation of either a.m. or p.m. is incorrect. Also, midnight is both twelve hours *before* noon and twelve hours *after* noon."

National Institute of Standards, Times of Day FAQs (https://perma.cc/Z44M-EAMH) (emphasis added).

The NIST FAQ document points out that drafters could use 24-hour (a.k.a. military) time, in which "0000" refers to midnight at the *beginning* of the day and "2400" to midnight at the *end* of the day.

## Clause 22.105 Mini-Trial to Senior Management

### 22.105.1 Right to submit disputes

Any party may submit a dispute,

no more than once per dispute if not otherwise agreed,

to a non-binding mini-trial before the parties' respective senior management representatives,

in accordance with the then-current mini-trial procedures of the International Institute for Conflict Prevention and Resolution (the "*Mini-Trial Rules*").

*Commentary*

Mini-trials to the parties' senior-management representatives are *the* most-effective approach to resolving disputes between companies, according to the head of litigation for a global Fortune 500 company, who said this at a local continuing legal education (CLE) panel discussion, moderated by the present author, about alternative dispute resolution. As summarized in the CPR's mini-trial procedures:

See https://tinyurl.com/CPR-MiniTrial (cpradr.org).

- A mini-trial typically consists of an abbreviated "closing argument" presentation, by each party's counsel, to a panel consisting of a senior-management representative of each party and a neutral presiding officer.
- After the presentations, the senior-management representatives confer privately, together with the neutral presiding officer, to see if they can work out a resolution to the dispute.

### 22.105.2 Required senior-management participation

Each party is to provide a senior management representative to participate personally in the mini-trial proceedings as called for by the Mini-Trial Rules.

*Commentary*

Two Australian lawyers point out that "[b]ringing in senior management will focus the minds of the parties on the bottom line, and allows senior decision makers who are not caught up in the underlying dispute to approach the situation taking commercial reality into account."

Faith Laube and Toby Blyth, Expert determination clauses in contracts – are they worth it? (MyBusiness.com.au 2015), archived at https://perma.cc/T2FP-D9BZ.

## Clause 22.106 Month Definition

a. *Month* refers to the Gregorian calendar unless unambiguously specified otherwise in writing.

b. A period of N months (where N is a number), when beginning on a specified date, ends at exactly midnight, in the relevant time zone:

at the end of the same day of the month N months later; or

if earlier, at the end of the last day of that later month.

c. Hypothetical examples:

1. A one-month period beginning on November 15 ends at exactly midnight at the end of December 15.

2. A two-month period beginning on December 31, 2023 ends at exactly midnight at the end of February 29, 2024 (a Leap Day).

*Commentary*

This definition could be useful for the avoidance of doubt in contracts involving companies in Muslim countries, and possibly in Israel, where a lunar calendar might be used.

See generally the blog post and comments at Ken Adams's post, Referring to the Gregorian calendar? (Nov. 14, 2013), especially the comments of Mark Anderson, Francis Davey, Richard Schafer, and Benjamin Whetsell.

## Clause 22.107 Need Not Definition

a. A statement in the Contract that a party need not take a particular action means that the Contract does not obligate the party to take that action.

b. IF: For any reason or no reason the party does not take the action in question; THEN: Unless the Contract clearly states otherwise, the party:

1. is to be conclusively deemed to have complied with any applicable standard of good faith, fair dealing, or reasonableness; and

2. is not to be liable for not taking the action under any legal- or equitable theory arising from *or* relating to the Contract;

each party WAIVES, and agrees not to assert, any contrary assertion.

*Commentary*

This is a roadblock clause to try to forestall claims that a party failed to comply with some implied obligation of good faith and fair dealing.

Subdivision b – deemed to comply with good-faith standards: This borrows from UCC 1-302(b) (which applies only to contracts that come within the scope of the UCC), which reads as follows: "The parties, by agreement, may determine the standards by which the performance of those obligations *[of good faith, etc.]* is to be measured if those standards are not manifestly unreasonable."

## Clause 22.108 Neutral Evaluation (Non-Binding)

a. Any party may submit a dispute to confidential, nonbinding, neutral evaluation,

no more than once per dispute (if not otherwise agreed),

at any time before the main adversarial hearing in a lawsuit or other proceeding concerning the dispute, including but not limited to arbitration,

in accordance with the then-effective early neutral evaluation procedures of the U.S. District Court for the Northern District of California (if not otherwise agreed).

b. The neutral evaluation is to take place by video conference unless otherwise agreed.

c. If either party so requests, the neutral evaluation is to be conducted as part of a mini-trial to the parties' senior management under [NONE].

Commentary

### 22.108.1 Business context

When a legal dispute arises, the parties' lawyers can sometimes tell their clients what they think the clients want to hear. That can hamper getting disputes settled and the parties back to their business (if that's possible).

### 22.108.2 Advantages of neutral evaluation

When a legal dispute arises, the parties' lawyers can sometimes tell their clients what they think the clients want to hear. That can hamper getting disputes settled and the parties back to their business, if that's possible.

(Lawyers might tell clients what they want to hear in part because they, the lawyers, tend to be overly optimistic about whether they're going to win their cases; this can be especially true for male lawyers.)

Consequently, if a contract dispute starts to get serious, an early, non-binding "sanity check" from a knowledgeable neutral can help the parties and lawyers get back onto a more-productive track before positions harden and relationships suffer — not to mention before the legal bills start to mount up.

### 22.108.3 Confidentiality; no binding effect

*Importantly,* under typical neutral-evaluation rules:

- a neutral evaluation has no binding effect, but of course any resulting agreed settlement could well be binding under applicable law; and
- the results of the neutral's evaluation are confidential and may not be used in court.

### 22.108.4 Subdivision a: Only one neutral evaluation per dispute

This Clause mandates only a single neutral evaluation; that's because it would be undesirable for a wealthy party to keep forcing a poorer party to incur the expenses associated with neutral evaluation.

Of course, parties are always free to agree to additional neutral evaluations — perhaps as the case gets further along, e.g., after discovery has been completed.

### 22.108.5 Subdivision a: Procedural rules

The neutral-evaluation procedures specified in [NONE] can be found (at this writing) online.

See https://www.cand.uscourts.gov/about/court-programs/alternative-dispute-resolution-adr/early-neutral-evaluation-ene/.

### 22.108.6 Subdivision b: Neutral evaluation via video conferences

Subdivision b requires video conferences for neutral evaluations, not least to reduce cost and burden. As little as a year ago at this writing (early 2021), this requirement likely would have been noteworthy; even today, many litigation counsel strongly prefer in-person dealings. But in the wake of the COVID-19 pandemic and the near-universal use of

Zoom calls, requiring neutral evaluation to be by video conference instead of in-person should be unremarkable.

#### 22.108.7 Subdivision c: Neutral eval during minitrial to senior management

This possibility is likely to be the most cost-effective approach.

## Clause 22.109 No-Shop

### 22.109.1 Terminology: "Shop the Deal," etc.

a. This Clause imposes restrictions on a party to the Contract ("*Seller*") for the benefit of another party to the Contract ("*Buyer*") in connection with a transaction agreed to in the Contract (the "*Transaction*"),

subject to a limited fiduciary-out exception in [NONE].

b. "*Competing Transaction*" refers to any transaction, or series of related transactions, similar in nature to the Transaction —

including but not limited to the following if the Transaction relates to a merger or acquisition involving Seller:

1. any merger, consolidation, share exchange, or other business combination involving Seller;

2. any disposition of a substantial portion of Seller's assets, whether by sale, lease, license, pledge, mortgage, exchange, or otherwise; and/or

3. any sale, exchange, or issuance of shares of stock (or, if applicable, of convertible securities) that, in the aggregate, represent a substantial portion of the Voting Power of Seller.

c. "*Participating Seller Representative*" refers to any Seller Representative (defined below) who is actively involved in the parties' discussions concerning the Transaction.

d. "*Seller Representative*" refers to any accountant, agent, attorney, director, employee, financial advisor, investment banker, officer, or

other representative of Seller or any Seller affiliate (see the definition in Clause 22.2).

e. "*Shop the Deal*," and corresponding terms such as Shopping the Deal, refer to the taking of any action that could reasonably be interpreted as having the purpose or effect of exploring, setting up, furthering, or finalizing a Competing Transaction. The term includes, without limitation:

1. initiating or soliciting discussion about a potential Competing Transaction; and

2. furnishing information (public or nonpublic) to a prospective party to a potential Competing Transaction.

*Commentary*

This Clause draws ideas from — but tries to simplify and streamline — various no-shop clauses found at the Lawinsider.com Website.

See https://www.lawinsider.com/clause/no-shop. See generally also No-Shop Clause (Investopedia.com).

### 22.109.2 No shopping the deal

Apart from the fiduciary-out exception of § 22.109.3, Seller:

1. must not Shop the Deal before termination of the Contract;

2. must promptly advise Buyer in writing of any inquiries and proposals received concerning possible Competing Transactions;

3. must neither authorize nor direct any Seller Representative or any other party to take any action inconsistent with Seller's obligations under this Clause; and

4. must, in writing, timely (see the definition in Clause 22.156) direct each Participating Seller Representative not to take any action inconsistent with Seller's obligations under this Clause.

### 22.109.3 Seller's "fiduciary out"

a. Nothing in the Contract is intended to preclude Seller from Shopping the Deal if Seller's board of directors, acting on advice of counsel and, if applicable, Seller's financial advisors, concludes:

1. that a potential Competing Transaction proposed by a third party, if consummated, would be more favorable to holders of Seller's stock than the Transaction; or

2. that Shopping the Deal is necessary or advisable for the board of directors to comply with its fiduciary duties under applicable law.

b. Seller must advise Buyer in writing, at least 48 hours beforehand, that it intends to take action under subdivision a.

c. Seller must advise Buyer in writing promptly upon receiving any communication (written or otherwise) from a third party,

if the communication could reasonably be interpreted as suggesting or inquiring about a potential Competing Transaction.

d. Seller need not furnish Buyer with the advice of its counsel or its financial advisors.

*Commentary*

A fiduciary-out clause will typically also allow a seller not only to shop the deal but to terminate an existing acquisition agreement, e.g., if a better offer comes along.

Merger- and acquisition ("M&A") agreements typically provide for a seller to pay the buyer a breakup fee if the seller exercises its fiduciary-out option.

See generally Richard Presutti, Matthew Gruenberg and Andrew Fadale, Private Equity Buyer/Public Target M&A Deal Study: 2015-17 Review (law.harvard.edu 2018).

## Clause 22.110 Noncompetition

*Commentary*

Some employment agreements (especially for executives) include covenants restricting or prohibiting the employee from competing with the employer *after* the employee leaves the company.

**Caution:** In some states such as California and Massachusetts, such covenants are likely unenforceable — and making an employee agree can cause severe legal problems for the employer — as discussed in the commentary below.

This Clause is intentionally set up with laughably-loose "default" parameters.

### 22.110.1 Applicability; parties

This Clause applies if the Contract requires a party ("*Restricted Party*") not to compete with another party ("*Company*").

*Commentary*

This Clause uses the term "Restricted Party" to fit noncompetes between two companies as well as between an employee and employer.

### 22.110.2 Business details worksheet

Unless the Contract clearly specifies otherwise, the following terms apply:

a. *Start of Noncompete Period:* The beginning of the business relationship, between Restricted Party and Company, to which the Contract relates (the "*Business Relationship*").

b. *End of Noncompete Period:* One day after the end, for any reason, of the Business Relationship, with the following notes:

1. Any termination or expiration of the Contract will mark the end of the Business Relationship unless unambiguously agreed otherwise in writing.

2. The Business Relationship could end without termination or expiration of the Business Relationship — for example, if Restricted Party is an employee of Company, then their Business Relationship (i.e., Restricted Party's employment) could end without the Contract being terminated or expiring.

c. *Noncompete Territory:* One hundred feet around Company's headquarters.

d. *Restricted Company Business:* Any business in which both of the following are true:

1. Company engaged in the business, or demonstrably made active preparations to enter the business, during the Business Relationship; and

2. Restricted Party EITHER: (i) participated in Company's business and/or active preparation, OR: (ii) had access to Company's confidential information concerning that business and/or active preparation.

e. *Competing Business:* Any business, by any individual and/or organization, when either (i) competing with, or (ii) preparing to compete with, any Restricted Company Business.

*Commentary*

Subdivision a: Noncompetes are typically agreed to by employees, and it only makes sense that an employee would agree not to compete with his- or her employer *while employed*.

Subdivision b: Most states that allow post-employment noncompetes require that they be reasonable in *time*; one year seems to be a fairly-typical allowable time period.

Subdivision c: The geographic boundaries of a noncompete must also be reasonable. Just what boundaries would qualify is so variable that the placeholder here is minimal to the point of risibility.

### 22.110.3 Prohibited activities during Noncompete Period

During the Noncompete Period, Restricted Party must not — directly or indirectly, for Restricted Party's own benefit or otherwise — do any of the following within the Noncompete Territory:

1. engage- or participate in any Competing Business, in any manner or in any capacity; nor

2. invest in, or lend money to, any other individual or organization that proposes or plans to do anything prohibited by subdivision 1, *except* for limited investments in publicly-traded equity securities as stated in subdivision 4 below; nor

3. otherwise knowingly assist any other individual or organization to do anything prohibited by subdivision 1; nor

4. own, in the aggregate, 5% or more of: (i) publicly-traded equity securities of any single organization engaging in any Competing Business; and/or (ii) securities convertible into, or exercisable or exchangable for, such equity securities.

*Commentary*

#### *22.110.3.1 States might restrict post-employment noncompetes*

*[IN PROGRESS]*

Famously, a California statute has been held to bar virtually all post-employment noncompetition covenants.

> See Cal. Bus. & Prof. Code § 16600.

A federal court held that a provision in an employment agreement, purporting to require assignment of *post-employment* inventions, was effectively a noncompetition covenant that was unenforceable under a separate provision of California law.

> See Whitewater West Industries, Ltd. v. Alleshouse, No. 2019-1852 (Fed. Cir. Nov. 19, 2020) (reversing judgment after bench trial), *citing* Cal. Bus. & Prof. Code § 16600.

Massachusetts also imposes restrictions on post-employment noncompetes, both generally and for specified professions.

> See Mass. General Laws c.149 § 24L; see generally Massachusetts law about noncompetition agreements (Mass.gov, undated): "A compilation of laws, cases and web sources on employee noncompetition law by the Trial Court Law Libraries."

See generally Stewart S. Mandela, Post-Employment Agreements Not To Compete (US) (ACC.com 2015)

#### *22.110.3.2 Specific examples of prohibited activities*

Some (overzealous?) drafters might want to list specific activities; the following have been harvested from various noncompetition clauses at LawInsider:

- • officer, director, manager (at any level), employee, partner, member (of LLC)
- • advisor, agent, consultant, contractor, distributor, joint venturer, manufacturer's representative, sales representative, service provider
- • owner, co-owner, investor
- • lender, guarantor, creditor

### 22.110.4 Legal counsel opportunity

Restricted Party acknowledges that Restricted Party has had the opportunity to consult with legal counsel of Restricted Party's choice concern-

ing Restricted Party's obligations under this Clause.

From mondaq: "The California Supreme Court just addressed this very question in Ixchel Pharma v. Biogen , holding that most B2B agreements are governed by the common law rule of reason, instead of the flat prohibition on noncompetes applicable to the employment context."

### 22.110.5 Blue-pencil request

The parties desire that this Clause be "blue-penciled" (see [NONE]) as necessary to preserve its validity.

*Commentary*

This is a narrow example of what are known as "saving clauses," examples of which can be found at LawInsider.com; see also the examples of severability clauses at the same site.

## Clause 22.111 Nonsolicitation

*[No clause text yet]*

*Commentary*

Some state governments have been applying pressure to companies to limit or stop requiring low-wage employees to sign noncompetes or otherwise restricting employee mobility. For example, Massachusetts, California, Illinois, Iowa, Maryland, Minnesota, New Jersey, New York, North Carolina, Oregon, and Pennsylvania all went after fast-food restaurant chains that had required franchisees to agree to "no-poach" provisions, under which a franchisee agreed not to try to hire employees from any other restaurant in the chain. New Jersey's attorney general announced a settlement with several restaurant chains:

> … The four companies agreeing to stop locking their workers into no-poach contracts are: Arby's, Little Caesar Enterprises, Five Guys Burgers and Fries and Dunkin' Brands.
>
> * * *

> Under the settlements announced today, the four participating franchisors have agreed to stop including no-poach provisions in any of their franchise agreements and to stop enforcing any franchise agreements already in place. The franchisors have also agreed to amend existing franchise agreements to remove no-poach provisions and to ask their franchisees to post notices in all locations to inform employees of the settlement. Finally, the franchisors will notify the participating Attorneys General if one of their franchisees tries to restrict any employee from moving to another location under an existing no-poach provision.
>
> New Jersey, Massachusetts and the other participating states began their investigation last July by sending letters to eight national fast-food franchisors: Arby's, Burger King, Dunkin' Brands, Five Guys Burgers and Fries, Little Caesars, Panera Bread, Popeyes Louisiana Kitchen and Wendy's. In those letters, Attorney General Grewal and the other Attorneys General expressed concern about "the potentially harmful impacts" of imposing no-poach requirements on fast-food workers.
>
> Among other concerns, the multi-state letters alleged that no-poach provisions make it difficult for workers to improve their earning potential by moving from an existing job at one franchise location to a more challenging and/or higher-paying position at another franchise location. The letters also noted that many fast-food workers aren't even aware they they're subject to these no-poach provisions.
>
> Since the investigation began, Wendy's announced that it will no longer use no-poach provisions in their contracts with franchisees. Investigations into Burger King, Popeyes, and Panera continue.

See, e.g., New Jersey Office of the Attorney General, Four Major Fast Food Companies Agree to Stop Using No-Poach Agreements that Restrict Worker Mobility (NJ.gov 2019) (with links to executed settlement agreements).

## Clause 22.112 Notices

a. *Effectiveness — "the Three Rs":* Notices required or permitted under the Contract will be effective upon receipt, refusal, or after reasonable unsuccessful attempts at delivery, in any case as established either:

1. by written acknowledgement of the addressee; and/or

2. by independent written confirmation, for example, from postal authorities or a nationally- or internationally-recognized courier service.

b. *Addresses:* Notices may be sent to any reasonable address unless clearly agreed otherwise in writing.

c. *Attention line in address:* IF: A notice is sent in hard copy or other physical form; THEN: The notice's delivery address should include an "Attention:" line directed to a position (preferred) or an individual, to reduce the chances of the notice's going astray; BUT: lack of an attention line will not in itself render the notice ineffective.

d. *Change of address:* A party may change its address for notice:

1. by giving notice to that effect in accordance with this Clause, or

2. by any other means reasonably calculated to communicate the change of address in a way that would get the attention of appropriate people at the other party.

e. *Additional copies:* The Contract may specify particular positions (preferred) and/or individuals to whom copies of notices must be sent.

Commentary

### 22.112.1 Email and other common ways of sending notices

Email is increasingly the major mode of business communication. (Some contracts make the categorical statement that notices by email are ineffective — that seems too extreme.)

Sending notices (or anything) by FAX seems to be less and less common, but sure, why not, as long as receipt can be independently confirmed, e.g., by a FAX machine printout or an email from an Internet-FAX service.

### 22.112.2 Caution: Don't require formal notice for everything

Some contracts' notices clauses impose overly-rigid procedural requirements. The Seventh Circuit was forced to confront such an argument in a case where the contract said, "*Any* notice or communication required or permitted hereunder … shall be in writing and shall be sent by registered mail, return receipt requested, postage prepaid." (Emphasis added.) The court ruled that "[t]o require the companies to send *every* communication via registered mail is commercially unreasonable, *if not absurd* in the twenty–first century."

> Kreg Therapeutics, Inc. v. VitalGo, Inc., 919 F.3d 405, 414 (7th Cir. 2019) (affirming summary judgment in favor of Kreg) (cleaned up, emphasis added).

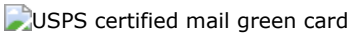
### 22.112.3 Subdivision a: Effectiveness of notices: "The Three Rs"

*(As set out in subdivision a, the Three Rs for effectiveness of notice are Receipt, Refusal, and Reasonable but unsuccessful attempts at delivery.)*

For a hard-copy notice, the requirement of independent confirmation can be met by sending the notice by certified mail or by courier with trackable delivery.

**Pro tip:** For hard-copy notices, include the tracking number *on the notice itself*. This can help forestall a claim by the addressee that the tracking number proved only that *some*

document had been delivered and not necessarily the notice document. (The present author once saw that happen in a court hearing: A lawyer claimed not to have received a notice; he admitted that the "green card" certified-mail receipt from the U.S. Postal Service had been signed by his assisstant but said that the receipt must have been for some other communication. The judge gave the benefit of the doubt to the lawyer — who several years later was disbarred for unrelated reasons.)


USPS certified mail green card

### 22.112.4 Note: Notices *not* effective X days after mailing

This Clause does *not* provide for notices to be effective a certain number of days after being mailed. In business-to-business ("B2B") contracts, the better practice is *not* to allow notices to be automatically effective a certain number of days after being mailed. As the Third Circuit said:

> In this age of computerized communications and handheld devices, it is certainly not expecting too much to require businesses that wish to avoid a material dispute about the receipt of a letter to use some form of mailing that includes verifiable receipt when mailing something as important as a legally mandated notice. The negligible cost and inconvenience of doing so is dwarfed by the practical consequences and potential unfairness of simply relying on business practices in the sender's mailroom.

Lupyan v. Corinthian Colleges, Inc., 761 F.3d 314, 322 (3d Cir. 2014).

For B2B contracts, when it comes to the question whether a particular notice has in fact been received, "that's a conversation I don't want to have" (to quote one of the author's former students in another context).

If a notice was actually received, a court is likely to consider the notice to have been effective, even if the contractual notice requirements were not strictly followed.

See, e.g., Rose, LLC v. Treasure Island, LLC, 445 P.3d 860, 863-64 (Nev. App. 2019) (with extensive case citations).

### 22.112.5 Regular-mail notices for B2C contracts?

In business-to-consumer ("B2C") contracts, the business might want to provide that notices *from the business* are effective a certain number of days after mailing; this allows the business to send out bulk-mail notices without having to comply with

Notices by regular mail can benefit from a so-called mailbox rule that applies in many jurisdictions. "When a letter, properly addressed and postage prepaid, is mailed, there exists a presumption the notice was duly received by the addressee. This presumption may be rebutted by proof of non-receipt. In the absence of proof to the contrary, the presumption has the force of a rule of law."

Stuart v. U.S. Nat'l Bank Ass'n, No. 05-14-00652-CV, slip op. at 4 (Tex. App.—Dallas Oct. 28, 2015) (affirming foreclosure on home) (cleaned up); see also, e.g., Rosenthal v. Walker, 111 U.S. 185, 193-94 (1884).

The presumption of receipt might even be statutory.

See, e.g., Mont. Code. Ann. 26-1-602, *explained in* Kenyon-Noble Lumber Co. v. Dependant *[sic]* Foundations, Inc., 2018 MT 308, 393 Mont. 518, 432 P.3d 133, 138 (2018) (affirming judgment

based on failure to rebut presumption of receipt).

But "unsupported, second-hand accounts *[of mailing]* cannot invoke the mailbox rule's presumption."

Guerra v. Consolid. Rail Corp., 936 F.3d 124, 137 (3d Cir. 2019) (affirming dismissal of plaintiff's complaint; plaintiff had provided insufficient evidence of timely mailing, to OSHA, of whistleblower complaint).

A notice-by-regular-mail clause could look like the following:

> A properly-addressed notice is rebuttably presumed to have been received three business days after being deposited
>
> - in the official mail of the jurisdiction where the notice is sent,
> - either with first-class postage or its equivalent affixed —
>   - certified- or registered mail or its equivalent is *not* necessary —
> - or in compliance with applicable bulk-mail regulations
>   - to reduce mailing expense.

**Pro tip:** Drafters might want to adjust the time at which notice by mail becomes effective, so as to match the expected postal delivery time.

### 22.112.6 Subdivision b: Addresses for notice

Many notices clauses specify *mandatory* addresses for notice, but such provisions are often cumbersome. Given that notices are effective only in the circumstances stated in subdivision a, the permissive approach of this section likely will be easier for the parties to manage.

### 22.112.7 Subdivision c: Attention line

Requiring an "Attention:" line that specifies *a position*, not an individual, can help to reduce the chances of a notice falling through the cracks. That could happen if, for example, an *individual* addressee was no longer in the same job and the notice was set aside in the mailroom — or forwarded to the individual at his- or her new job.

### 22.112.8 Subdivision d: Change of address

As a safe harbor (see Section 11.5: ), subdivision d.1 allows sending a change of address by formal notice. In addition, though, subdivision d.2 allows any other reasonable means of sending a change of address, because parties don't always dot the i's and cross the t's when they change their address.

**Pro tip:** Contracting parties should be diligent about updating their address records — a commercial real-estate tenant's failure to do so caused it be stuck paying the landlord an extra year's rent, for space the tenant was no longer using, because (1) the tenant initially sent its notice of non-renewal to the landlord at an outdated address, and (2) the tenant's follow-up notice, to the new address, arrived too late, and so under the

terms of the lease, the lease term had automatically been renewed for the additional year.

See Commercial Resource Group, LLC v. J.M. Smucker Co., 753 F.3d 790 (8th Cir. 2014).

#### 22.112.9 Subdivision e: Additional copies

An address for notice could specify, for example, "With a copy to the attention of the Legal Department." (It's often helpful to loop in the addressee's Legal Department sooner rather than later.)

#### 22.112.10 A more-detailed notices provision

Participants at the private, lawyers-only online forum Redline.net (disclosure: the present author is a longtime participant), run by Califonia lawyer Sean Hogle, came up with a notices clause that goes into more detail about when notices are effective.

## Clause 22.113 Order Fulfillment

*Note to drafters: See also the optional terms in Section 22.114: .*

#### 22.113.1 Introduction & parties

a. This Clause will apply when, under the Contract, specified parties, referred to as "*Customer*" and "*Supplier*" respectively, agree to conduct one or more transactions,

> such as, for example, (i) one or more sales or other deliveries of tangible- or nontangible goods, equipment, or other deliverables; and/or (ii) the performance of services.

b. Each such transaction agreement is referred to as an "*Order*."

c. In case of doubt: Unless otherwise agreed in writing, "Customer" might not be an end-customer, but instead might be a reseller, a distributor, etc.

*Commentary*

*Note to drafters: See also the optional terms at § 22.114, which are not incorporated by reference into the Contract unless it clearly says so.*

### 22.113.2 Packaging and labeling

a. Supplier is to cause all deliverables to be appropriately packaged and labeled for shipment and delivery; this includes, without limitation, conformance to:

1. any requirements of law (including for example any required country-of-origin labeling);

2. any specific packaging- and/or labeling instructions in the Order,

b. IF: Customer provides a purchase-order number or other identifier for the order; THEN: Supplier is to cause that identifier to be included on shipping labels, shipping documents, and Order-related correspondence.

*Commentary*

Anyone who has ever bought prepackaged food at a U.S. grocery store will know that packaging and labeling of goods can be a non-trivial affair, often regulated by government authorities.

### 22.113.3 Variations in delivery time

a. Supplier is to cause deliverables specified in the Order to be delivered in the time frame stated in the Order (if any).

b. While an Order might specify a delivery time, Supplier will not be liable if the actual delivery time is early or late,

as long as the variation is not unreasonable under the circumstances,

unless the Order clearly states otherwise.

*Commentary*

How much flexibility should a supplier have in the timing of delivery? Let's assume that if the customer wants to insist that delivery timing is critical, then the order can say so.

Subdivision a is phrased as "Supplier *is to cause delivery*" instead of "Supplier *will deliver*" because in many cases Supplier will use a carrier to actually make the delivery.

Alternative:

> Supplier is to *endeavor* to cause delivery …."

(Emphasis added.)

Subdivision b — alternative:

> Time is of the essence for delivery.

See generally the commentary on "time is of the essence" at Section 21.18: .

### 22.113.4 Passage of title and risk of loss

Title and risk of loss will pass as stated in INCOTERMS 2020 DDP if the Order does not specify otherwise.

*Commentary*

As a default measure, this section puts the onus on Supplier to get the goods to Customer's door unless otherwise agreed.

Passage of title and risk of loss is important commercially. Here's a not-so-hypothetical case: Suppose that Supplier, in Asia, ships thousands of rubber ducks to Customer, in the U.S., all packed in a standard 40-foot shipping container and transported first by truck, then by rail, then by sea, and finally again by truck to Customer's location.

- *Title* will pass at some point in the journey; when that happens, Customer, not Supplier, will now own the rubber ducks (and thus typically can direct what is to be done with them).
- *Risk of loss* will also pass at some point in the journey (possibly a different point). Let's see how that might play out: Suppose that, for our shipment of rubber ducks, during the sea voyage a storm causes the shipping container to be washed overboard and to break open, sending the ducks floating away in different directions. If risk of loss had passed to Customer before that time, then Supplier would have no responsibility for replacing the rubber ducks. (That's what insurance is for — but under the parties' contract, who had responsibility for obtaining and paying for insurance?)

IRL (In Real Life), in 1992 thousands of plastic yellow "rubber ducks," red beavers, blue turtles, and green frogs were indeed lost at sea during a Pacific Ocean storm. Some of the toys eventually drifted thousands of miles, making possible some significant oceanographic research.

See Friendly Floatees (Wikipedia.org).

A convenient way of specifying when title and risk of loss will pass is to utilize one of the INCOTERMS 2020 three-letter options, which provide a detailed menu of choices for things such as responsibility for freight charges, insurance, and export- and customs clearance, in addition to passage of title and risk of loss. For example:

- EXW (Ex Works) means, in essence, that the supplier will make the goods available for pickup at the supplier's place of business, but everything from that point on is the responsibility of the customer;
- DDP (Delivered Duty Paid) is the other extreme: The supplier is to deliver the goods to the customer's place of business with all formalities taken care of and all charges paid.

The Australian global logistics firm Henning Harders provides a useful graphic depiction of how risk of loss shifts under the various INCOTERMS options

### 22.113.5 Order fulfillment - discussion questions

1. What are some pros and cons of spelling out, in the contract, the information that Customer must submit in an order?
2. What are some pros and cons of:

   having each order become an addition to the master agreement, versus

   having each order be a separate agreement that incorporates the master agreement by reference.
3. Why might a supplier want a quotation to have an expiration date?
4. What are some pros and cons of allowing orders to be modified orally and not requiring written modifications?

FACTS: You represent Supplier. Customer wants its "affiliates" to be listed in the preamble as parties to the agreement, e.g., "The parties are ABC Inc. ('Supplier') and XYZ Inc. and its affiliates ('Customer')."

QUESTIONS: *(numbering is continued before)*

5. As Supplier's lawyer, what do you think of this — what do you think Customer *really* wants?
6. How might you structure the contract to accommodate Customer's likely desires — *and* to protect Supplier?
7. What are the INCOTERMS? What does "EXW" mean?

## 22.114 Order fulfillment: Optional clauses

None of the following options will apply except to the extent, if any, that the Contract unambiguously says otherwise; blank ballot boxes ☐ below, if any, are intended to signal this visually.

### 22.114.1 Option: Stocking Point Delivery

a. An Order may specify that ordered deliverables are to be delivered to a warehouse (or other stocking point) until called for Customer.

b. For any such Order, both title and risk of loss for the ordered deliverables will pass to Customer only when those deliverables are released for final delivery to Customer.

*Commentary*

Just-in-time delivery of goods to stocking points is sometimes used by manufacturers to ~~minimize~~ reduce* the amount of their capital that is tied up in inventory. Such a manufacturer might require a supplier to deliver parts and other components — still owned by the supplier, and thus tying up the *supplier's* capital — until needed by the manufacturer.

See generally, e.g., Everything you need to know about Just in Time inventory management (tradegecko.com), archived at https://perma.cc/L7Y9-DDSM.

* *Reduce* might be a safer term than *minimize*, for reasons discussed at Section 11.8.1: .

### 22.114.2 Option: Deliverables Substitution

None of the following options will apply except to the extent, if any, that the Contract unambiguously says otherwise; blank ballot boxes ☐ below, if any, are intended to signal this visually.

☐ Supplier may not substitute different deliverables for those specified in the Order without Customer's prior written consent.

☐ Supplier may make substitutions for deliverables specified in an Order, but only if all of the following prerequisites are met:

1. The substituted deliverables must meet any functional specifications stated in the Order for the ordered deliverables.

2. Supplier must advise Customer of the substitution, in writing, no later than the scheduled time for delivery.

3. Customer may reject the substituted deliverables on or before 14 days after the date of delivery.

*Commentary*

Sometimes the ordered goods aren't available; parties' contracts could address that using one of the above options.

### 22.114.3 Option: Partial- or Early Deliveries

None of the following options will apply except to the extent, if any, that the Contract unambiguously says otherwise; blank ballot boxes ☐ below, if any, are intended to signal this visually.

☐ Customer may, in its sole discretion, reject any delivery that is incomplete or that is not delivered on the date specified in the Order;

- if Customer does so, that will not affect any right or remedy Customer might have arising from the delivery failure.

☐ Supplier may, in its discretion, ship partial deliveries of ordered deliverables,

- but not if Customer notifies Supplier otherwise a reasonable time in advance.

*Commentary*

A customer might want its deliveries to be all-or-nothing, so that the customer's people won't have to spend time dealing with deliveries that don't conform exactly to the Order.

On the other hand, a supplier might want to be able to ship goods as they're finished, without waiting for the entire Order to be completed.

Either preference could be addressed using language such as the above.

### 22.114.4 Option: Shortages Flexibility

If Supplier runs short of ordered deliverables, for whatever reason or reasons, then Supplier may do some or all of the following:

1. allocate Supplier's available production as Supplier deems appropriate;

2. delay or stop shipments; and/or

3. send partial shipments with prior notice.

*Commentary*

This section amounts to a very-barebones (and one-sided) force-majeure provision.

A supplier and customer might want to give some thought to more-detailed planning for shortages of the supplier's product. That's an especially-salient point in the wake of the COVID-19 pandemic.

See also generally Tango Clause 22.62 - Force Majeure.

### 22.114.5 Option: Environmental Damage Responsibility

As between Supplier and Customer, Supplier is responsible for any and all environmental damage arising from ordered deliverables to Customer until Customer receives the deliverables.

*Commentary*

Some customers' purchase-order terms explicitly require the supplier to assume responsibility for environmental damage until delivery.

### 22.114.6 Option: Shipping-Document Consolidation

Supplier is encouraged to consolidate shipping documents wherever practicable.

*Commentary*

This is a small thing and wouldn't necessarily apply in every situation, so it's an option instead of a standard part of a clause.

### 22.114.7 Option: Shipment Advice

a. Supplier will promptly advise Customer in writing when deliverables specified in an Order have been shipped.

b. Supplier will promptly provide any specific details reasonably requested by Customer, such as (for example) tracking informa-

tion for the shipment.

*Commentary*

This is another small thing.

### 22.114.8 Option: Release Documentation

Promptly after Supplier delivers ordered deliverables to a carrier for shipment to Customer,

- Supplier will send Customer any documents necessary for Customer to cause the deliverables to be released to Customer or Customer's designee.

*Commentary*

Purpose: Especially for international shipments, a supplier might cause goods to be delivered somewhere for eventual pickup by the customer (e.g., a customs-bonded warehouse). In that situation, the customer might need specific documents to be able to claim the goods. So, this option explicitly requires the supplier to provide such documentation.

See generally, e.g.: David Noah, 8 Documents Required for International Shipping (ShippingSolutions.com 2020); Arnesh Roy, A Glossary of International Shipping Terms (ShippingSolutions.com 2020).

### 22.114.9 Option: Delivery Delay Warning

Supplier will promptly advise Customer, preferably in writing, if a reasonable person would conclude that a delivery is likely not to meet the schedule specified in the relevant Order.

(In case of doubt: Supplier's advising Customer of a possible delay, in itself, will not affect any right or remedy Customer might have for an actual delay.)

*Commentary*

Especially for just-in-time manufacturing, some customers might want a heads-up if a supplier's scheduled delivery is likely to be delayed.

### 22.114.10 Option: As-Delivered Problem Reporting Requirement

Customer will promptly advise Supplier, in writing,

- of any mismatch that Customer finds
- between the type, quantity, and price of deliverables specified in an accepted Order
- and the deliverables actually delivered.

*Commentary*

Purpose: A supplier might want to put the monkey on the customer's back to alert the supplier to any problems with an order.

### 22.114.11 Option: Customer Handling of Rejected Deliverables

a. Customer may direct that rejected deliverables be returned to Supplier (at whatever address Supplier specifies) at Supplier's expense.

b. Customer may store rejected deliverables, at Supplier's risk, pending Customer's receipt of Supplier's return shipping instructions.

c. Supplier will pay, or reimburse Customer for, all charges for storage, insurance, and return shipping of rejected deliverables.

d. If Customer rejects one or more deliverables as authorized by this Agreement,

- but Supplier does not provide Customer with pre-paid return shipping instructions within a reasonable time,
- then Customer may, in its sole discretion:
  - 1. destroy some or all of the rejected deliverable(s);
  - 2. sell some or all of the rejected deliverable(s), at a commercially reasonable public- or private sale; and/or
  - 3. otherwise dispose of some or all of the rejected deliverables.

e. If Customer sells some or all of the rejected deliverables, it will apply any proceeds in the following order:

1. expenses of the sale;
2. storage charges not paid for by Supplier;

3. any other amounts due to Customer from Supplier; and
4. payment of any remaining balance to Supplier.

*Commentary*

A customer might find it burdensome to deal with a rejected shipment; the above terms are quite customer-favorable.

Up next: *Supplier*-favoring options, in [NONE].

### 22.114.12 Option: Supplier Handling of Orphaned Deliverables

a. This Option will apply if, through no fault of Supplier or its contractors, Customer is not ready to receive some or all deliverables under an accepted Order on the schedule specified in the Order.

b. Supplier may cause the relevant deliverables to be stored at a site reasonably selected by Supplier.

- Such a site might be under the control of Supplier or a third party (such as, for example (see the definition in Clause 22.59), a freight forwarder).

c. Both title and risk of loss for stored deliverables will immediately pass to Customer (if that has not already happened).

d. Supplier may deem its delivery of the relevant deliverables to be complete once those deliverables are put into storage,

- and therefore Supplier may invoice Customer for any remaining amount due.

e. Customer will reimburse Supplier for all expenses incurred by Supplier in connection with putting the relevant deliverables into storage.

f. When Customer is able to accept delivery of the stored deliverables, Supplier will arrange for delivery,

- but Supplier need not do so if one or more of Supplier's invoice(s) relating to the Order in question is past due.

*Commentary*

These options are basically the *supplier*-favoring mirror image of the *customer*-favoring terms in Option 22.114.11.

### 22.114.13 Option: Terms for Order size

None of the following options will apply except to the extent, if any, that the Contract unambiguously says otherwise; blank ballot boxes ☐ below, if any, are intended to signal this visually.

☐ Customer may submit an Order of any size.

☐ Supplier may decline an Order for goods or other deliverables if the ordered quantity of any single stock-keeping unit (SKU) is less than [QUANTITY].

☐ Supplier may decline an Order where the aggregate Order price is less than [AMOUNT], exclusive of taxes, shipping, and insurance.

*Commentary*

A supplier might well be concerned with economies of scale — especially for goods that are manufactured to order — and so the supplier might want to establish a minimum order quantity (MOQ). One of the options abovecould be adapted for that purpose.

See generally, e.g., Justin Reaume, 6 Procurement Actions that Can Boost Your Business (SCMR.com 2010), archived at https://perma.cc/56CD-MYEG.

### 22.114.14 Option: Terms for Supplier's acceptance of Orders

None of the following options will apply except to the extent, if any, that the Contract unambiguously says otherwise; blank ballot boxes ☐ below, if any, are intended to signal this visually.

☐ Supplier may decline any proposed Order in its sole discretion. (In case of doubt: Here, *decline* has the same meaning as *reject*.)

☐ Supplier will not unreasonably decline an Order.

☐ Supplier will not decline any Order.

☐ If Customer has failed to pay amounts due to Supplier when due,

- then Supplier may decline subsequent proposed Orders by Customer
- until all such past-due amounts have been paid.

☐ Supplier is deemed to have accepted an Order,

- and to have waived its right to decline or otherwise reject the Order,
- if Supplier has not declined the Order in writing
- within five business days after Supplier receives the Order.

☐ If Customer has failed to pay amounts due to Supplier when due,

- then Supplier may revoke Supplier's acceptance of Customer's Orders that Supplier previously accepted but has not yet filled or completed.

☐ Supplier may not revoke its acceptance of an Order.

☐ Supplier may revoke its acceptance of an Order only under the following circumstances: [DESCRIBE].

*Commentary*

Sometimes, when negotiating a master purchase agreement, a supplier and a customer might have a bit of a tug-of-war over the supplier's autonomy in accepting a customer order:

- At one extreme, the supplier might want to be free to reject any order for any reason or no reason;
- At the other extreme, the customer might want to require the supplier to accept any customer order whatsoever.

Drafters can adapt one or more of the optional terms above as desired.

### 22.114.15 Option: Terms for Customer Cancellation of Order

None of the following options will apply except to the extent, if any, that the Contract unambiguously says otherwise; blank ballot boxes ☐ below, if any, are intended to signal this visually.

☐ Customer may cancel an Order for goods that are not to be specially manufactured for the Order — but Customer may do so only before Supplier has shipped the goods — by sending a written cancellation advice to Supplier.

☐ Customer may not cancel an Order for goods that are to be specially manufactured for the Order.

☐ Customer may not cancel an Order for services.

☐ Customer may not cancel an Order for goods once the Order has been accepted by Supplier.

☐ An Order for goods or other deliverables will not be deemed canceled unless Supplier receives a written cancellation request, signed by an authorized representative of Customer, no later than *[SPECIFY DEADLINE]*.

☐ IF: Customer cancels an Order for goods or other deliverables; THEN: Supplier may invoice Customer for, and Customer will pay, a cancellation fee of *[SPECIFY AMOUNT]*.

*Commentary*

The options above could be helpful to drafters in another possible tug-of-war between supplier and customer, namely how much autonomy a customer would have to cancel an order.

### 22.114.16 Option: Advance Payment Requirement

Supplier reserves the right, in its sole discretion (see the definition in Clause 22.49),

- to require Customer to pay in full, in advance for an Order;
- this will be true even if the Contract otherwise provides for Supplier to perform first and be paid later.

*Commentary*

This option could be useful in a master purchase agreement.

## Clause 22.115 Order Submission

### 22.115.1 Introduction & parties

a. This Clause will apply when, under the Contract, specified parties, referred to as "*Customer*" and "*Supplier*" respectively, agree to conduct one or more transactions,

such as, for example, (i) one or more sales or other deliveries of tangible- or nontangible goods, equipment, or other deliverables; and/or (ii) the performance of services.

b. Each such transaction agreement is referred to as an "*Order*."

c. In case of doubt: Unless otherwise agreed in writing, "Customer" might not be an end-customer, but instead might be a reseller, a distributor, etc.

*Commentary*

In the business world, sales typically happen by a customer's submission of an order form of some kind (e.g., a "purchase order"). This might be preceded by the seller's sending the (prospective) customer a sales quotation — which might itself be preceded by the customer's sending a request for proposal ("RFP") or a request for quotation ("RFQ"). This Clause sets out standardized terms for submission of orders.

(Concerning order *fulfillment*, see [NONE].)

### 22.115.2 Supplier's order-submission process

Supplier may decide, from time to time —

1. what mechanism it will use to receive orders, for example via hard copy, email, Web-based portals, etc.; and

2. what information must be included in an Order.

*Commentary*

There's not much point to having a contract lock in the mechanisms for the customer to submit an order, because the supplier will be (or at least *should* be) motivated to make the process as easy as possible for the customer.

- True, a supplier's finance- and legal departments might want customers to jump through a lot of hoops.
- But the *sales* department will surely have something to say about that.

If a supplier really wants to put these details *into the contract*, it can look to section 2 of a Honeywell terms-of-sale document, which calls for orders to specify only the following sensible items: "(1) Purchase Order number; (2) Honeywell's part number; (3) requested delivery dates; (4) price; (5) quantity; (6) location to which the Product is to be shipped; and (7) location to which invoices will be sent for payment."

See https://perma.cc/5MB9-H6VK.

### 22.115.3 Supplier quotation as "offer"

a. IF: Supplier sends Customer a quotation for a proposed sale or other transaction; THEN: That quotation constitutes Supplier's offer to conduct the transaction on the terms specified in the quotation, including but not limited to any terms incorporated by reference.

b. If Customer accepts a Supplier quotation,

including but not limited to by sending a purchase order,

then that quotation becomes an Order.

*Commentary*

This section is relevant because in Anglo-American jurisprudence, an "offer" and "acceptance" of the offer are two of the elements required to form a binding contract.

Also needed for an enforceable contract: • Consideration; • a "meeting of the minds"; and • the legal "capacity" to enter into a contract.

See also Tango Clause 22.55 - Entire Agreement concerning the effect of additional terms in purchase orders, etc.

### 22.115.4 Supplier's ads, catalogs and price lists ≠ "offers"

Any advertisements, catalogs, and/or price lists of Supplier — whether for goods or other deliverables; services; or other items — do not constitute Supplier's offer to sell or otherwise deal in any particular quantity of the item(s) at any particular time or place.

*Commentary*

The idea for this provision comes from section 1 of a Honeywell terms-of-sale document archived at https://perma.cc/5MB9-H6VK.

Why include this section? Because:

- A basic tenet of Anglo-American contract law is that if M makes an "offer" to N, then *N has the power to bind the parties to a contract by accepting the offer* (assuming that the other required elements are present).
- So now suppose that a supplier publishes one or more advertisements, and maybe a catalog, and perhaps a price list: By doing so, has the supplier made an "offer" that J. Random Customer can accept — and legally bind the supplier — by placing an order?

Generally the answer is "no," but a supplier might want to make this clear; hence, this section.

### 22.115.5 Expiration of quotations

IF: A Supplier quotation specifies an expiration date; THEN: The quotation will expire on that date *unless* Supplier receives Customer's acceptance of the quotation, before the close of business, at Supplier's relevant location, on that date.

*Commentary*

Purpose: It's not uncommon for a supplier to send a sales quotation to a customer, but the customer takes its time thinking about it and deciding whether or not to buy. The supplier probably wants to put an expiration date on the quote. That's because as time passes, the supplier might do one or more of the following, in which case filling the customer's sudden order might be challenging:

- The supplier might stop making the product that's the subject of the sales quotation;
- The supplier might raise its prices; and/or
- The supplier might decide, for whatever reason, that it no longer wants to deal with that customer at all —
    - Perhaps the supplier has decided that the customer is going to be too much trouble to work with;
    - Perhaps the supplier has engaged a reseller for the territory (see [NONE]) and now wants the customer to deal with the reseller instead of directly with the supplier.

What about the reverse situation, where there's no pending offer *by the supplier* (e.g., no sales quotation), but a customer has sent a purchase order but then never hears from the supplier? In that situation, UCC § 2-206 would come into play:

> (1) … (b) an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either [i] by a prompt promise to ship or [ii] by the prompt or current shipment ….
>
> (2) Where the beginning of a requested performance is a reasonable mode of acceptance an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance.

(Bracketed romanettes added.)

### 22.115.6 Modification or withdrawal of a pending quotation

Supplier may withdraw and/or modify a quotation at any time —

until Supplier has *received* Customer's timely acceptance, if any,

or (if applicable) the quotation expires by its terms,

whichever occurs first,

unless the quotation expressly states otherwise.

*Commentary*

As noted in the commentary to [NONE], a customer might sit on a supplier's sales quotation; when that's the case, the supplier might want the flexibility to modify or even withdraw the quote.

The language "until Supplier has *received* Customer's timely acceptance" is intended to overrule the so-called mailbox rule (or, posting rule) that acceptance of an offer is effective when mailed.

See generally Posting rule (Wikipedia.com).

Here's a variation: What if a sales quotation (unwisely) says to the customer, in effect, "there's no rush, we'll honor this sales quotation whenever you can find the time to look at it"? When that happens, UCC § 2-205 might come into play:

> An offer by a merchant to **buy** or **sell** goods
>
> in a signed writing which by its terms gives assurance that it will be held open
>
> is not revocable, for lack of consideration, during the time stated
>
> or if no time is stated for a reasonable time,
>
> but in no event may such period of irrevocability exceed three months;
>
> but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

Emphasis and extra paragraphing added.

### 22.115.7 Orders and change orders in writing

a. An Order, or a change to an accepted Order ("*change order*"), must be agreed to in writing unless the requirements of subdivision b are met.

b. Any assertion of an *oral* Order, or an oral agreement to modification of an Order, must be supported by clear and convincing evidence (see the definition in Clause 22.30).

c. An Order must be agreed to by both Supplier and Customer.

d. A change order must be agreed to by (at least) the party against which the change order is sought to be enforced.

e. An Order or a change order may be agreed to on behalf of a party by any person having *actual*- or *apparent* authority.

*Commentary*

*22.115.7.1 Subdivision a: Writing required (usually)*

When parties M and N are dealing with each other, they often want (or should want) to make it clear that they will only be bound by *written* agreements, because they don't want to get bogged down later in "he said, she said" arguments about what the parties supposedly agreed to *orally* — but *modifications* to an existing agreement might be another story.

Note the "unless" language above: Parties might want to leave *some* room for oral *modifications* of written agreements, because how it often happens in the real world. So:

Why require corroboration? To reduce the chances of "creative" memory and even fraud, as discussed in the commentary to Tango Clause 22.38 - Corroborating Evidence. This could be an issue because in some jurisdictions, a party might be able to successfully claim an oral amendment or modification (or waiver) even if the contract contained an amendments-in-writing clause; this is discussed in more detail in the commentary to Tango Clause 22.4 - Amendments.

This might be less of an issue when it comes to the sale of *goods*, because UCC § 2-209(2) provides as follows:

> a. An agreement *modifying a contract* within this Article needs no consideration to be binding.
>
> (2) A signed agreement which excludes modification or rescission except by a signed writing *cannot be otherwise modified or rescinded*, but except as between merchants *[basically, regular buyers and sellers of goods of the kind]* such a requirement on a form supplied by the merchant must be separately signed by the other party.
>
> (3) The requirements of the statute of frauds section of this Article (Section 2-201) *[which requires certain contracts to be in writing]* must be satisfied if the contract as modified is within its provisions.
>
> (4) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) or (3) it *can* operate as a waiver.
>
> (5) A party who has made a waiver affecting an executory portion *[i.e., a not-yet-started portion]* of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

Emphasis added.

Alternative:

> Any Order, and any change to an Order, must be in writing; no party will assert that an Order was agreed to or modified in any other way.

#### *22.115.7.2 Subdivision d: Signature for change orders*

This requirement borrows from the approach of UCC § 2-201, which requires that certain written contracts must be "signed by the party against whom enforcement is sought or by his authorized agent or broker."

Alternative:

> A change order must be agreed to by both parties.

#### *22.115.7.3 Subdivision e: Apparent authority*

Apparent authority is pretty much the legal standard for signature authority; see the discussion at Section 3.11.4: .

Alternative:

> An Order or a change order must be agreed to on behalf of a party by an officer of the party at the vice-president level or higher.

Language like this alternative is often seen in boilerplate forms; for example, a car dealer might well ask its customers to sign a contract that explicitly states that the sales person doesn't have authority to offer a better warranty. (That's another case of trying to avoid future "he said, she said" disputes about what was allegedly promised.)

### 22.115.8 Customer-specified delivery to third party

a. Customer may designate, in writing, a third party to which deliverables are to be shipped.

b. Customer's designation of the third party must take place a reasonable time before shipment.

c. Customer must respond promptly to any reasonable requests by Supplier for information about the third party,

> for example (see the definition in Clause 22.59), to determine whether Supplier may legally ship the deliverables to the third

party because of export-control restrictions or other legal factors.

d. Supplier is to cause the deliverables to be shipped to the third party, absent reasonable objection on Supplier's part.

e. Customer is to pay any additional costs arising from Customer's designation (for example, additional shipping, additional insurance, etc.).

*Commentary*

Sometimes a customer might place an order with a supplier but wants the supplier to have the order delivered to a third party, such as a contractor. To allow for that possibility:

**Caution:** Supplier might have legitimate reasons for *not* wanting to ship ordered goods to particular third parties. For example, a third party might be a competitor of Supplier, or the third party might be on a bar list of some kind, e.g., under the export-control laws.

### 22.115.9 Submission of Orders by Customer affiliates

a. If the Contract unambiguously says so (or Supplier otherwise unambiguously agrees in writing), Customer's affiliates (see the definition in Clause 22.2) may submit one or more proposed Orders for transactions with Supplier under the Contract.

b. If an Order by a Customer affiliate is accepted by Supplier, then the Order will be governed by the Contract in the same manner as if Customer had submitted the Order.

c. A proposed Order from a Customer affiliate will not be binding on Supplier unless and until Supplier agrees to the Order,

in Supplier's sole discretion (see the definition in Clause 22.49).

*Commentary*

It's not uncommon for a corporate customer to negotiate some kind of master purchasing agreement with a supplier for both the customer itself and the customer's affiliates (see [NONE] for a pretty-standard definition).

- The *bad* approach is to have the contract say that the parties are "Customer Corporation *and its affiliates* (see the commentary at § 3.5.8).
- The *better* approach is to simply say that the customer's affiliates may place orders, as in this section.

Subdivision c – not binding until Supplier acceptance: Supplier might want to decline an order from a Customer affiliate, for example if Supplier doesn't have a basis for believing that the affiliate is sufficiently creditworthy. (In which case, Supplier might be willing to accept an affiliate order if Customer guarantees payment; see generally [PH]).

### 22.115.10 Customer responsibility for affiliate orders

Customer is not responsible for its affiliates' obligations under their Orders (if any), unless Customer unambiguously agrees otherwise in writing (perhaps in the Order itself).

*Commentary*

Purpose: Suppose that a customer's foreign affiliate wants to place an order under the customer's contract with a supplier. Will the *customer* be financially responsible if its *affiliates* don't pay for their orders? That might be an important issue for the supplier, especially in the case of foreign affiliates, where the supplier might find it burdensome or expensive to try to collect unpaid invoices.

Alternative:

> If a Customer affiliate enters into an Order with Supplier under the Agreement for a transaction, then Customer is jointly and severally liable, together with its affiliate, for the affiliate's obligations under that Order.

### 22.115.11 Orders as separate agreements

Each Order is to be considered a separate agreement that incorporates the Contract by reference,

including but not limited to this Clause,

whether or not the incorporation is explicit.

*Commentary*

Purpose: Some contracts state that every order is an "addition" to the underlying agreement; this is seen, for example, in the ISDA Master Agreement, where "netting out" of multiple transactions is desired.

In the author's view, however, the "addition" approach would be unwise for everyday commercial orders, because:

- a default in one order could affect other orders — this is sometimes referred to as "cross-default" and should be provided for expressly if desired; and
- if the supplier's liability for damages were to be capped at "the amounts paid or payable under this Agreement," then that amount would grow over time as more statements of work were completed; the customer might like that, but the supplier wouldn't be wild about it.

Alternative:

> Each Order is to be considered an addition to this Agreement and not as a separate agreement.

## Clause 22.116 Organization Definition

*Organization* refers to any of the following: • a corporation; • a business trust; • estate; • a trust; • a general- or limited partnership; • a limited liability company; • an association; • a joint venture; • a joint stock company; • a government; • a governmental subdivision, agency, or instrumentality; • a public corporation; and • any other legal or commercial entity that has a legal identity apart from its members or owners.

*Commentary*

This "laundry list" is adapted from:

- UCC §1-201(25) and 1-201(27);
- the definition of *person* in U.S. securities laws, at 15 U.S.C. § 77b(a)(2); and
- *entity*, Black's Law Dictionary (10th ed. 2014), *quoted in* Ineos USA LLC v. Elmgren, 505 S.W.3d 555, 563 (Tex. 2016).

## Clause 22.117 Other Necessary Actions

a. Each party is to:

1. sign and deliver any other commercially-reasonable documents (see the definition in Clause 22.32), and

2. take any other commercially-reasonable actions,

as may be reasonably requested by the other party, if necessary to further the clear purpose of the Contract.

b. IF: The parties disagree about what constitutes reasonable action for purposes of this Clause; THEN: The parties are to manage that disagreement in accordance with Tango Clause 22.52 - Dispute Management,

including but not limited to Tango Clause 22.19 - Baseball Arbitration (to encourage each party to be reasonable in its position).

Commentary

This Clause and language like it are sometimes seen in merger- and acquisition agreements, but rarely in everyday commercial agreements.

Subdivision a: The use of several instances of "reasonably" is intentional:

- Suppose that Party 1 requests that Party 2 take a particular Action A.
- In the abstract, Action A might be commercially reasonable — *in context*, however, Party 1's request might *not* be reasonable under the circumstances.

Subdivision b: Chances are that a disagreement of this nature will never go very far into a dispute-management process.

## Clause 22.118 Past Dealings Disclaimer

The parties do not intend, and neither party is to assert, that the parties' past dealings will have the effect of modifying or supplementing the Contract.

Commentary

Language like this is sometimes seen in companies' "canned" standard forms, e.g., in customers' purchase-order terms and conditions and sellers' terms of sale.

Caution: Agreeing to this Disclaimer could later put a party at a disadvantage in possibly-unpredictable ways.

## Clause 22.119 Payment Security

### 22.119.1 Applicability; parties

This Clause applies if the Contract calls for a party ("*Payer*") to establish security ("*Payment Security*") for payments that are to be made to, or for the benefit of, another party ("*Beneficiary*").

*Commentary*

#### *22.119.1.1 Business context*

> Business bad? Eff you, pay me. Oh, you had a fire? Eff you, pay me. Place got hit by lightning, huh? Eff you, pay me.

— Mobster Henry Hill in the movie *Goodfellas* (sanitized).

When might one party want another party to establish payment security as a backup source of funding? An obvious example is when a party is to be paid under a contract and wants to be sure that the paying party has the funds to make the payment on time.

But that's not the only reason a party might want payment security to be obtained. Consider a common example:

- A landowner enters into a "prime contract" with a general contractor ("GC" or "prime") to get a building built.
- The prime contract contemplates that the GC will hire, coordinate, *and pay*, various specialist subcontractors ("subs") to demolish the existing building ("demo work"); pour a foundation for the new building; erect the building's frame and roof; install electrical wiring; install plumbing; and so on.
- The GC's obligation to pay its subs is important to the owner: If the GC were to fail to pay a sub, the law would likely allow the sub to demand payment from the owner — which likely has already paid the GC — and/or to place a lien on

the owner's property, thus placing a "cloud" on the owner's title and complicating the owner's life.

See generally Mechanic's lien (Wikipedia.org); Mechanic's Lien Definition (Investopedia.com). See also the general discussion of subcontracts at Section 21.15: .

For that reason, in negotiating the prime contract with the GC, the owner might well require the GC to obtain "payment security" to make sure that the subs got paid.

(The prime contract likely would also require the owner to obtain financing from a bank or other lender, so that the GC would have assurance that *it* would be paid.)

[TO DO: Diagram showing payments by customer to contractor to subcontractor?]

#### *22.119.1.2 Possible sources of backup funding*

Here are a few possible backup sources of funding:

1. A supplier could ask for a **deposit,** possibly into "escrow," to be held by a third party until stated conditions are met.

See Tango Clause 22.48 - Deposits and its commentary; see also Escrow (Investopedia.com).

2. A supplier could ask its customer to provide a **standby letter of credit** ("SLOC") — in return for a fee, *a bank* agrees to pay the amount due if necessary; in effect, a SLOC is a prearranged line of credit *for the payee* with *the payer's* bank, with the payer being responsible for repaying the bank.

See generally Standby Letter of Credit (Investopedia.com); compare with Sight Letter of Credit (same).

3. A supplier could ask its customer for a **guaranty** from a third party.

See Tango Clause 22.74 - Guaranties and its commentary.

4. The supplier could ask to take a **security interest** in real estate or other property (tangible or intangible), referred to as "collateral."

An *advantage* of a security interest is that, if an amount due remains unpaid, then the payee can force a sale of the collateral and keep as much of the proceeds as is needed to pay the amount due, with any remaining proceeds going to the party that owed the money. BUT: A security interest in collateral must be properly established and "perfected" (the manner of perfection depends on the nature of the collateral; it generally involves filing a notice of some kind in public records, so as to put the public on notice of the payee's security interest).

See generally Security interest and Foreclosure (Investopedia.com).

This means that two *disadvantages* of a security interest are:

- parties don't always get around to the paperwork to perfect a security interest; and
- foreclosing on collateral costs time and money — especially if the collateral owner tries to get a court to stop the process, as sometimes happens.

Bottom line: A security interest is likely not the *preferred* payment security of choice for suppliers or other payees.

5. A customer hiring a contractor could ask the contractor to buy a **payment bond** from an insurance carrier: If the contractor fails to pay its subcontractors, then the insurance carrier is responsible for paying any unpaid suppliers and subcontractors. (The insurance carrier will usually try to recoup its payment(s) from its insured, the nonpaying contractor.)

See generally Payment bond (IRMI.com).

Payment bonds are usually required in "prime" contracts between a customer and a prime- or general contractor. The intent is to keep the prime contractor's unpaid subcontractors and suppliers from filing a mechanic's lien or materialman's lien (nowadays often referred to as a "supplier's lien") on the customer's project.

See generally Mechanic's lien (Wikipedia.org).

6. A customer hiring a contractor could ask the contractor to buy a **performance bond**, a.k.a. a contract bonds, to have a backup pot of money available:

- to fund a party's performance of its contractual obligations, such as the bonds required of companies holding certain oil and gas leases granted by the U.S. Government; and/or

  See 30 C.F.R. § 556.900, *cited in* Taylor Energy Co. v. United States, No. 19-1983, slip op. at 4-5 (Fed. Cir. Sept. 3, 2020) (affirming dismissal of Taylor Energy's complaint for failure to state a claim upon which relief can be granted);

- to hire a replacement contractor to finish work that the original contractor either failed to do or failed to do correctly.

  See generally Performance bond (Investopedia.com).

Of course, these bonds aren't free: if a contract requires a contractor to obtain and pay for a payment bond and/or a performance bond, the contractor generally will build the cost of the bond (i.e., the premium that the contractor pays to the insurance carrier for the bond) into the price of the project.

### 22.119.2 Form requirements for payment security

All Payment Security must:

1. take the form of an irrevocable, unconditional letter of credit or a Bank guarantee;

2. be issued (or confirmed) by the Bank; and

3. be on terms reasonably acceptable to (and approved in advance by) the Beneficiary.

*Commentary*

For other possible types of payment security, see the commentary to [NONE].

### 22.119.3 Required duration of payment security

The Payer must establish the Payment Security and keep it in force as set forth in this Clause for at least three months after the latest to occur of the following:

1. the last scheduled shipment of ordered goods, if any;
2. completion of all ordered services, if any; and
3. the Beneficiary's receipt of the final payment covered by the payment security.

*Commentary*

The Beneficiary might want to specify other events that will start the expiration countdown clock running.

### 22.119.4 Eligibility requirements for the Bank

a. "*Bank*" refers to any and each party that agrees to provide Payment Security, whether or not formally a bank.

b. The Bank must be reasonably acceptable to the Beneficiary; BUT: The Beneficiary will be deemed to have WAIVED any objection to the Bank if the Beneficiary has not stated all of its then-existing grounds for objection, in writing, to the Beneficiary, no later than two business days after learning, by any means, of the identity of the Bank.

*Commentary*

The Beneficiary will obviously want the Bank to be a solvent, reliable financial institution — and one that is subject to a convenient jurisdiction in which to be sued for payment, if that should prove necessary.

### 22.119.5 Coverage requirement

IF: The Contract calls for the delivery of goods and/or the performance of services; THEN: The Payment Security must provide for payments by

the Bank of past-due amounts in the following categories:

1. pro-rata payments required by the Contract:

    for goods as they are shipped,

    and for services as they are performed,

    in all such cases as applicable to the relevant order;

2. payment of any cancellation- or termination charges under the order; and

3. payment of any other amount that the Payer owes in connection with the order.

*Commentary*

The above language draws on ideas seen in § 2.2 of a General Electric terms-of-sale document archived at https://perma.cc/8LRL-PFL3.

A contract drafter might want to supplement the above list with one or more specific additional items.

### 22.119.6 Confirmation of Payment Security by Bank

a. The Payer must cause the Beneficiary to be provided with written confirmation — from the Bank, not from the Payer — that the payment security has been established.

b. The Bank's confirmation must be received by the Beneficiary no later than five business days after the parties' agreement to the purchase order or other order that requires payment security.

*Commentary*

This requirement comes from the Trust-But-Verify Desk: When a beneficiary asks a payer to provide payment security, it's a good idea for the beneficiary to require formal confirmation *from the security provider* that the security has in fact been established, just in case the payer might be tempted to provide a forged- or otherwise-fraudulent confirmation.

### 22.119.7 Prerequisite to performance; deadline adjustment

a. If the Beneficiary is to be a payee of the Payer under an order,

then the Beneficiary need not begin its performance under the order,

nor need the Beneficiary continue its performance, if already begun,

until the Beneficiary has received confirmation of the fully effective payment security,

and/or any confirmation of required modified payment security (see [NONE]),

as required by this Clause and/or the applicable order.

b. In any case in which the Beneficiary delays its performance under subdivision a, all deadlines under the Contract for that performance will be automatically extended accordingly.

*Commentary*

The Beneficiary likely will prefer to wait on doing any work, and/or incurring any financial obligations of its own, until the payment security is in place.

### 22.119.8 Modification of Payment Security

a. The Payer must modify the payment security if reasonably requested in writing by the Beneficiary.

b. The Beneficiary must provide the Payer with a reasonably-detailed written explanation of the basis for the modification request,

accompanied by copies of any evidence relied on by the Beneficiary in that regard.

c. Whether the Beneficiary's request is reasonable is to be determined with reference to the circumstances, which may include, without limitation:

1. the Payer's payment history, and/or

2. any other fact reasonably relevant to the Payer's ability and/or willingness to pay.

d. Any dispute about whether a requested payment modification is reasonable is to be addressed in accordance with Tango Clause 22.52 - Dispute Management.

e. The Payer must arrange:

1. for each payment modification to be confirmed in accordance with [NONE]; and

2. for the Beneficiary to receive the confirmation no later than ten business days after the Payer receives the Beneficiary's written request for modification.

*Commentary*

Circumstances can change, including a beneficiary's comfort level that the payer will make the necessary payments — in which case the beneficiary might want the security to be modified. Modification might be appropriate, for example —

- if the payer was consistently late with payments, and/or
- if the payer otherwise appeared to be having financial difficulties.

A requested modification to payment security could include, without limitation, one or more of the following:

1. an increase in the coverage amount of the payment security;
2. an extension of the term of the payment security;
3. changing to another bank; and/or
4. any other appropriate modifications to the payment security reasonably requested by the Beneficiary.

Drafters might want to add more-specific examples as "safe harbor" reasons for a beneficiary to request a payment modification.

The above modification language bears a passing resemblance to UCC § 2-609, which states (in the context of a sale of goods):

> (1) A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired.
>
> When reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return.
>
> (2) Between merchants the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.
>
> (3)Acceptance of any improper delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.
>
> (4) After receipt of a justified demand failure to provide within a reasponable time not exceeding thirty days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.

(Extra paragraphing added.)

### 22.119.9 Payer's responsibility for costs

The Payer must see to the payment of all costs and expenses associated with establishing, confirming, and maintaining the Payment Security.

*Commentary*

The bank or other financial institution providing payment security is unlikely to do so for free (unless the payment security is folded into some other credit arrangement that the Payer already has with the bank). The Contract should spell out who is responsible for paying the Bank.

(Of course, the Payer will likely build its cost of payment security into what it charges its customer.)

### 22.119.10 Material breach to fail to maintain Payment Security

The Payer's failure to timely provide, maintain, and/or update, the required fully effective Payment Security will be a material breach (see the definition in Clause 22.102.2) of the Contract on the Payer's part.

*Commentary*

Courts will generally defer to a contract's explicit statement that a particular type of breach would be "material" (and thus would carry specific consequences), as discussed in the commentary at Section 22.102: (which also explains why it matters whether a particular breach is deemed "material").

## Clause 22.120 Payment Terms

### 22.120.1 Payment due date

Except as provided in [NONE], a paying party must pay each invoice net 30 days after receiving the invoice.

*Commentary*

*22.120.1.1 The meaning of "net 30 days"*

The term "net X days" (where X is a number) means that payment *in full* is due in X days. So, in this section, "net 30 days" means that payment in full is due 30 days after invoice receipt.

See, e.g., Net D (Wikipedia.org).

*22.120.1.2 Net X days starting when?*

A supplier would of course like to have payment be due net X days after the *date of the invoice*. That gives the supplier an easy way of tracking its accounts receivable: The invoice is overdue on the date X+1 days after the date of the invoice, as recorded in the supplier's books.

In contrast, a customer will normally prefer payment to be due net X days after the customer has *received* the invoice in question, because the customer needs (or simply wants) more time to process the invoice — and because the customer might wonder whether the supplier's billing system will send invoices out on or shortly after the invoice date.

It makes some sense to do it the second way, as the customer prefers, because the supplier has more control over when the invoice will be received, and the supplier can also follow up to make sure that the customer in fact received the invoice.

(In the modern era of electronic invoicing, much of the above "admin" work is done automatically.)

*22.120.1.3 Typical payment deadlines*

As a general rule, people who are owed money would prefer to be paid as soon as possible. On the other hand, paying parties prefer to hold onto their money as long as possible. (This is known as using using "OPM" — Other People's Money — to finance one's business operations.) It's not unheard of for customers to want to make suppliers wait a long time to be paid; for example:

- Net 30 days is pretty standard for payment for goods; net 45 days and even net 60 days are generally considered to be within the band of reasonableness, more or less.
- Contractors and other service providers often ask for net 10 or net 15 day terms, or even "due on receipt" (not uncommon for law-firm invoices to clients).
- Some customers demand net 75, net 90, and even net 120 days (GE reportedly did this at one point).

- Section 13 of a Honeywell purchase-order form says: "Payment terms are net 75 days …. *Payment will be scheduled* for the first payment cycle following the net terms for the Purchase Order."

For additional discussion, see Joanne Simpson, Extended payment terms: who really pays the price? (IACCM.com 2016), https://perma.cc/43ZF-8PMU.

#### *22.120.1.4 Discount for early payment?*

Some contracts will say, for example: "Invoice payments are due 2% 10 days, net 30 days …" This means that:

- the paying party may deduct 2% as a discount for payment in full within *10 days*,
- but payment in full is due in any case within *30 days*.

#### *22.120.1.5 What if an invoice is submitted after an agreed deadline?*

A late-submitted supplier invoice might cause serious accounting problems for a customer. Consequently, it's not unknown for a customer to say (for example, in the boilerplate terms and conditions of its purchase-order form) *we must receive your invoices no later than X days after the end of our fiscal quarter — and we need not pay the invoice if we receive it after that*.

Such a "death penalty" for late-submitted invoices should be clearly agreed to in advance; see [NONE] and its commentary for additional discussion,

#### *22.120.1.6 Factoring to avoid a long wait for payment*

A payee that doesn't want to wait months for its money could consider factoring, namely selling its invoice to a third-party "factor" at a discount. "A factor is essentially a funding source that agrees to pay the company the value of an invoice less a discount for commission and fees. Factoring can help companies improve their short-term cash needs by selling their receivables in return for an injection of cash from the factoring company."

Factor (Investopedia.com).

### 22.120.2 Disputing an amount due

a. If a paying party wants to dispute an invoice, it must do the following *no later than the payment due date*:

1. pay any undisputed portion;
2. advise the invoicing party — in writing, in reasonable detail — why the paying party is disputing the invoice; and

3. provide the invoicing party with copies of all relevant documentation concerning the parts that the paying party is disputing.

b. IF: The paying party does not dispute the invoice as stated in subdivision a; THEN:

1. The invoice will be presumed to be correct *unless* the paying party shows — by clear and convincing evidence (see the definition in Clause 22.30) — that the invoice was wrong; BUT

2. Any audit rights that the paying party has under the Contract (see [NONE]) must also be honored.

The invoice will be presumed correct.

a. If the parties are unable to resolve a dispute about an invoiced amount, they are to proceed as stated in Tango Clause 22.52 - Dispute Management.

Most invoices probably get paid without issue. But when that's not the case, it can be quite useful for the parties to have an established protocol that's designed to help them exchange the information they need to understand each other's positions, the better to settle the disagreement as quickly as possible.

*Commentary*

*22.120.2.1 The importance of promptly challenging incorrect invoices*

Paying parties should promptly challenge incorrect invoices, because:

• In some jurisdictions, if a party pays an incorrect invoice without protest, the paying party might not be able to recover the overpayment.

See, e.g., A&B Deli Inc. v. 251 Sixth Ave., LLC, 2020 NY Slip Op. 30650(U), No. 451990/2018 (N.Y. Sup. Ct. Feb. 28, 2020) (dismissing tenant's suit to recover overpayment of taxes to landlord, citing cases). See generally James D. Abrams and Erica L. Cook, Voluntary Payment Doctrine: A Useful Affirmative Defense or Instrument of Evil? (AmericanBar.org.2016), archived at https://perma.cc/5HY2-9YD2.

• And in some jurisdictions, there might be a *statutory* deadline for a customer to object to a contractor's invoice, under what are known as "prompt payment acts."

See, e.g., Matt Viator, Know Your States Prompt Payment Act To Speed Up Construction Payments (LevelSet.com 2018).

*22.120.2.2 Why a deadline for raising payment disputes?*

When a paying party wants to dispute a charge, it might be tempted to wait to raise the dispute until the payment is due, as a cynical way of extending the payment

terms. That kind of nickel-and-diming behavior shouldn't happen in a cooperative business relationship; hence, the desirability of imposing a deadline for raising a payment dispute.

#### *22.120.2.3 Subdivision a.3: Documentation requirement*

A paying party wishing to dispute an invoice should provide the invoicing party with documentation to support the payer's position in the dispute — *and* with a reasonably-specific explanation, so that the payer doesn't try to do a "document dump" that tells the invoicing party (in effect), *we gave you the documents, YOU figure it out*.

### 22.120.3 Payment methods

A payer may pay an obligation under the Contract using any reasonable means to which the payee has not reasonably objected.

*Commentary*

Some widely-used payment methods include the following:

• *Check:* The check could be required to be drawn on (i) a U.S. bank, or (ii) a specifically-identified bank, or (iii) any bank to which the Creditor does not reasonably object in writing. **Important:** When an ordinary check is written, the money stays in the payer's account until the check is "presented" to the payer's bank for payment. This means that the check might not clear if the payer were to file for bankruptcy protection, because the account might be frozen. (These days, check clearance is almost always done electronically if the payee uses a different bank.) See Check (Investopedia.com).

• *Automated clearing house ("ACH")* electronic debit transaction in lieu of a check. **Caution:** Again, if the payer files for U.S. bankruptcy protection before the check clears, then the check might never clear; see the bankruptcy discussion in section [TO DO]. See Automated Clearing House (ACH) (Investopedia.com).

• *Certified check*: A *certified* check is written by the payer and drawn on the *payer's* account, *but* the bank guarantees to the payee that the bank has *put a hold* on the payer's account for the amount of the check, meaning that the check should not bounce. **Note:** With a certified check, the *money stays in the payer's account until the check clears* — this means that the same bankruptcy issues exist as for regular checks. **Caution:** Certified checks can be counterfeited, in which case the bank might not have to pay, and if the payee cashes the check, the payee might have to refund the money. See Certified check (Investopedia.com).

• *Cashier's* check: A *cashier's* check is written *by the bank itself*, not by the payer. When writing the check, the bank *transfers* the stated amount of money from the payer's account to the bank's own account. (Note the difference between this and a

*certified* check, discussed above.) The parties' agreement might specify what bank, or what type of bank, is to be used. **Caution:** Cashier's checks can be counterfeited, meaning that the payee might be on the hook as noted above. See Cashier's check (Investopedia.com).

• *Wire transfer* to give the payee "immediately-available funds" that could be immediately withdrawn and spent if desired. See Wire transfer and Available funds (each at Investopedia.com).

**Caution: Don't include bank-account information in the contract itself:** Sometimes you'll see a contract that includes bank-account information for payments. That's not a good idea: If for any reason the contract were to become publicly available — such as one of the parties' having to file it with the SEC as a "material agreement" — then the bank-account information could end up floating around out there on the Internet for all to see. (A better way to do that is to say in the contract that the paying party will separately provide written wire-transfer information.)

### 22.120.4 Payment does not affect payer's rights

In case of doubt, the fact of a payment, standing alone, will not limit any rights that the paying party has concerning the subject of the payment unless the paying party unambiguously agrees otherwise in writing.

*Commentary*

Suppose that a customer hasn't yet paid a supplier invoice, and the customer and the supplier are having a dispute about something relating to the invoice. In that situation, the customer might fear that paying the invoice could be interpreted as acceding to the supplier's position; the above language is intended to assuage any such customer fear:

### 22.120.5 Order of application of payments

A payee is to apply payments:

1. first to accrued interest, if any, then
2. to unpaid principal,

in each case in the order in which the paying party's payment obligations were incurred (that is, oldest-first).

*Commentary*

If a paying party is being charged interest, the payee likely will want all payments to be applied first to any unpaid interest, so as to keep the unpaid principal balance as high as possible — and thus still incurring interest charges — for as long as possible. Language along these lines is often seen in promissory notes and other loan documents, as well as in contract language allowing interest to be charged for past-due payments.

This specific language is adapted from a suggestion in David Cook, *The Interest Tail Wags the Profit Dog*, in *Business Law News* Issue No. 3, 2014 (State Bar of California Business Law Section; available on-line to Section members).

### 22.120.6 COD terms after late payment(s)

A payee may require a paying party to pay cash-on-delivery (COD) in the future if the paying party:

1. has been *repeatedly* late in paying the payee; or
2. has been *significantly* late with one or more significant payments.

*Commentary*

Applicable law might well *implicitly* permit a supplier to revert to cash-on-delivery ("COD") terms if late payment of previous amounts due constituted a material breach (see the definition in Clause 22.102.2) of the Contract. But it can't hurt to make this explicit, in part because applicable law might vary:

### 22.120.7 Late payment ≠ IP infringement

A payee will not be entitled to remedies for infringement of its intellectual-property rights solely because the paying party did not timely pay one or more amounts required by the Contract.

*Commentary*

If a customer were late in paying the price of a purchased product, the vendor *could* try to claim that the customer's *unpaid* use of the product infringed the vendor's intellectual-property rights — and that the customer therefore owed the vendor a lot more money as infringement damages. A customer might not want that possibility hanging overhead, and so might want language such as that of this section.

> See MDY Indus., LLC v. Blizzard Entm't., Inc., 629 F.3d 928, 939-41 at n.4 (9th Cir. 2010) (dictum): "A licensee arguably may commit copyright infringement by continuing to use the licensed work while failing to make required payments, even though a failure to make payments otherwise lacks a nexus to the licensor's exclusive statutory rights."

True, it's likely that few vendors would be so short-sighted as to sue a customer for IP infringement solely because the customer was late in paying an invoice. But one or more *individuals* at a vendor might want to grasp at the prospect of a short-term payday, not caring about the long-term effects on the vendor-customer relationship.

And sometimes vendors *can* get greedy; see, for example, the *Cincom* case, in which:

> See Cincom Sys., Inc. v. Novelis Corp., 581 F.3d 431 (6th Cir. 2009) (affirming summary judgment in favor of software vendor).

- An unincorporated division of a customer corporation bought a license to use a vendor's software on a specific computer at a specific location; the customer paid the required license fee.
- Some 14 years later, the customer conducted a corporate restructuring that resulted in the software being operated *on the same computer, at the same location*, but under the auspices of a newly-created corporate affiliate instead of by the originally-licensed unincorporated division.
- The vendor took the position that this was an unauthorized assignment of the license (which technically it was; see the commentary to [NONE]) and successfully sued the customer for copyright infringement, winning a damage award of more than $459,000.

The *Cincom* vendor's actions have always struck the present author as ill-advised, because there's probably no way that the customer would ever do business with that vendor again, and the vendor's reputation among prospective customer likely took a hit because of its actions.

But the prospect of a big payday from a claim of IP infringement could be very real. For example, an appeals court upheld a jury's award of $5 million, or 2.2% *of defendant's total profits* for the period in question, as "disgorgement" copyright damages for the defendant's infringement of the plaintiff's computer software.

> See ECIMOS, LLC v. Carrier Corp., 971 F.3d 616 (6th Cir. 2020)

Tangentially related on the issue of damages for infringement: In an older case, the MGM Grand Hotel ("MGM") casino floor show was found to infringe the copyright in the Broadway musical *Kismet* because:

- MGM was licensed to use the copyrighted material for a movie and for elevator music.
- MGM was *not* licensed to use the material for a floor show.

The resulting damage award against MGM for copyright infringement included 2% of MGM's profits *from the hotel operations as a whole, including the casino itself*.

> See Frank Music Corp. v. Metro-Goldwyn-Mayer, Inc., 886 F.2d 1545 (9th Cir. 1989) (*Frank Music II*).

It didn't help MGM's case that MGM's annual report had praised the infringing floor show's contribution to the hotel- and casino operations, saying that "the hotel and gaming operations of the MGM Grand — Las Vegas continue to be materially enhanced by the popularity of the hotel's entertainment[, including] 'Hallelujah Hollywood', the spectacularly successful production revue…."

*Frank Music I*, 772 F.2d 505, 517 (9th Cir. 1985) (alterations by the court).

### 22.120.8 Special case: Pay-when-paid

IF: An invoicing party has unambiguously agreed in writing that an invoice need not be paid until the paying party is itself paid by a third party; THEN:

1. the paying party must diligently make commercially-reasonable efforts to collect what the third party owes to it; and

2. the paying party must pay the invoice party within a reasonable time after the stated invoice due date,

even if the paying party has not yet collected what the third party owes.

*Commentary*

Pay-*when*-paid and pay-*if*-paid clauses are sometimes seen in *subcontracts* where the prime contractor (or general contractor) asks the subcontractor to agree that the prime contractor need not spend its own money to pay the subcontractor. When this will be the case in a contract, it's useful to lay out ground rules, so that all concerned enter into the contract with their eyes open.

If a prime contractor actually receives funding to make a pay-when-paid or a pay-if-paid payment, then the payer shouldn't sit on the money — but on the other hand, the payer shouldn't have to early-pay the invoice just because the payer has the necessary funding in hand.

For a pay-*when*-paid obligation, if a prime contractor's customer does not pay a prime contractor within a reasonable time, then the prime contractor — or perhaps the insurance carrier that wrote the prime contractor's payment bond, if there is one — should (and here, *must*) pay the subcontractor anyway.

**Pro tip:** Courts seem more likely to give effect to a pay-*if*-paid clause if the creditor explicitly assumes the risk of nonpayment (although not necessarily in so many words).

Cf. BMD Contractors, Inc. v. Fid. & Dep. Co., 679 F.3d 643, 649-50 (7th Cir. 2012) (making an *Erie* guess about Indiana law and affirming summary judgment in favor of surety), where the court said: "While the subcontract might have gone further — for example, it might also

have said that BMD assumed the risk of the property owner's insolvency — this additional language was not necessary to create an enforceable pay-if-paid provision." *Id.* at 645.

**Caution 1:** In some jurisdictions, a pay-*if*-paid clause might mean that an unpaid creditor cannot seek payment from a surety (e.g., from a payment bond) if there is one.

See BMD Contractors, *supra*, 679 F.3d at 649.

**Caution 2:** Because a pay-*if*-paid clause essentially puts the risk of non-payment on the subcontractor, in some jurisdictions the clause **might be void as against public policy**. For example:

• In New York, pay-*if*-paid clauses are void, but pay-*when*-paid clauses are enforceable, according to that state's highest court. See West-Fair Elect. Contractors v. Aetna Cas. & Surety Co., 87 N.Y.2d 148, 158, 661 N.E.2d 967 638 N.Y.S.2d 394 (1995) (on certification from Second Circuit).

• In contrast, the Ohio supreme court upheld a pay-*if*-paid clause, affirming a summary judgment that the contract's "condition precedent" payment language was sufficient totransfer the risk of nonpayment by a customer from the prime contractor to its subcontractor.

See Transtar Electric, Inc. v. A.E.M. Electric Serv. Corp., 2014 Ohio 3095, 140 Ohio St. 3d 193. The decision was criticized for not addressing public-policy considerations; *see* Scott Wolfe, Jr., Ohio Supreme Court Gets Pay If Paid Decision Wrong, Hurts Subcontractors (ZLien.com 2014).

• In New Jersey, the courts are split about pay-if-paid clauses.

See Michelle Fiorito, The Consequences of "Pay-If-Paid" and "Pay-When-Paid" Construction Contracts Clauses (ZDLaw.com 2012).

• Still another court — in passing, and arguably in a dictum — seems to have implicitly treated a pay-if-paid clause as a pay-*when*-paid provision.

See Allstate Interiors & Exteriors, Inc., v. Stonestreet Constr., LLC, 730 F.3d 67, 70 (1st Cir. 2013) (affirming judgment below).

• The Seventh Circuit made an *Erie* guess that Indiana courts would uphold a pay-if-paid clause.

See BMD Contractors, *supra*, 679 F.3d at 649.

For additional information, see generally, e.g., Robert Cox, Pay-if-Paid Clauses: A Surety's Defense for Payment Bond Claims? (JDSupra.com 2019).

### 22.120.9 Offset: Prerequisites

a. A party making a payment under the Contract must not take an offset — that is, reduce its payment by amount(s) that the paying party

believes that the payee owes to the paying party — except in accordance with this section.

b. Any offset taken must be of a "liquidated" (that is, a clearly- and precisely-established) amount due.

c. An offset may not exceed the liquidated amount that the Creditor owes to the Payer under subdivision b.

d. If the Payer does take an offset, the Payer must:

1. advise the Creditor in writing that the Payer is taking an offset;

2. provide the Creditor with a reasonable written explanation of each offset; and

3. provide the Creditor with:

(i) citations to specific portions of supporting documentation, and

(ii) copies of such documentation that the Creditor does not already have.

*Commentary*

An "offset" occurs when Alice owes money to Bob but reduces her payment by the amount that she claims that *Bob* owes to *her*. For example, a U.S. Treasury Department Webpage says that "If an individual owes money to the federal government because of a delinquent debt, the Treasury Department can offset that individual's federal payment or withhold the entire amount to satisfy the debt."

In subdivision d.3 above, the requirement for reasonably-specific citations seeks to forestall a "document dump" by a paying party that tells the payee, in effect, *you've got the documents, YOU figure it out*.

**Caution:** Apparently in some places (e.g. France), an *automatic* right of offset might not be enforceable, according to a LinkedIn comment. See http://goo.gl/aW-pjDv (LinkedIn group membership required).

### 22.120.10 Exercise: Late payment

From an actual contract clause: "(4) *Penalty for late payments:* Late payments are subject to a penalty of 5%."

EXERCISE: Spot the issues.

*(Be careful — as stated, the facts give rise to some hidden issues!)*

# Clause 22.121 Performance Improvement Plan Protocol

## 22.121.1 Applicability; parties

This Clause will apply when:

1. a specified party — referred to for convenience as "*Performer*," whether an individual or an organization — is not meeting performance requirements that were agreed to with another party ("*Observer*"); and

2. Observer desires to have Performer adopt and comply with a performance-improvement plan.

*Commentary*

Unfortunately, there's folk wisdom that when an employee is put "on plan," it's actually a tacit signal that, in reality, "the plan" is for the employee to use the time to find another job before the axe falls. An experienced HR executive has said:
"A manager only puts you on a Performance Improvement Plan when they want to get rid of you. Instead of a Performance Improvement Plan, it should be called This is the First Step Toward Firing You Plan, because that is what's happening."

Liz Ryan, The Truth About 'Performance Improvement Plans' (Forbes.com 2016).

Not entirely convincingly, another writer is more optimistic: "While the seriousness of them shouldn't be ignored, if you are put on a PIP, know that all hope is not lost. You have the power to turn your performance around–and save your job!"

Michelle Y. Costello, Your Boss Put You On A Performance Improvement Plan, Now What? (FastCompany.com 2018).

For general information about performance improvement plans in the workplace — which can have issues that might not appear in a B2B context — see generally Society for Human Resource Management, How to Establish a Performance Improvement Plan (SHRM.org, undated).

## 22.121.2 Performance improvement plan development and adoption

a. *Invocation by Observer:* To trigger this Clause, Observer must give Performer notice (see the definition in Clause 22.112) to that effect; the notice must specify, in reasonable detail, in what respects Performer has failed to meet the previously-agreed performance requirements.

b. *Deadline for Performer proposal:* Performer will have five business days after the effective date of Observer's notice under subdivision a, to propose to Observer,

> by notice,
>
> a written plan — reasonably acceptable to Observer — to improve Performer's performance to the previously-agreed levels,
>
> including but not limited to appropriate milestones and deadlines.

c. *Discussions:* Performer's proposed plan should *preferably* (but doing so is not mandatory):

> 1. be developed in consultation with Observer; and
>
> 2. include provisions for scheduled "catch-up" calls with Observer; see generally Tango Clause 22.147 - Status Conferences.

d. *Deadline for Observer objection:* Observer will be deemed to have accepted Performer's proposed improvement plan if Observer does not object, in reasonable detail,

> by notice to Performer,
>
> on or before five business days after the effective date of Performer's notice to Observer that proposes the plan.

e. *Disputes over plan reasonableness:* IF: The parties disagree over whether Performer's proposed plan is reasonable; THEN: The parties are to address the dispute in accordance with Tango Clause 22.52 - Dispute Management.

*Commentary*

The idea behind this section is to provide a sensible framework for developing and implementing a PIP, so that the plan has at least a respectable chance at succeding.

### 22.121.3 Failure = material breach; no cure period

If Performer —

1. fails to propose a reasonably-acceptable improvement plan as provided above, or

2. fails to meet an approved plan's requirements in one or more *material* respects,

then the failure(s) will be a material breach of the Contract,

with no cure period required except at Observer's sole discretion (see the definition in Clause 22.49).

*Commentary*

The performance-improvement plan is itself the "cure period," so there's no reason to have yet-another cure period after a material failure to comply with the plan.

## Clause 22.122 Personnel Qualifications

IF: The Contract states that particular individuals must meet the requirements of this Clause;

THEN: All such individuals:

1. must be competent and suitably trained for their assigned tasks;

2. must be legally bound by individual obligations that are sufficient to support any corresponding obligations that their employer(s) have under the Contract —

including, without limitation (if applicable), obligations of confidentiality and/or to assign ownership of their inventions;

3. must be legally able to be employed in any jurisdiction where they are to be physically present; and

4. must meet any other qualifications that are agreed to in, or under, the Contract.

Commentary

22.122.1 A comfort-and-confidence clause …

Suppose that you, the reader, signed a contract with Scalpels 'R Us, LLC, to do lifesaving surgery on one of your children. At a minimum —

- You'd want to know that the actual surgeon, the specific individual who would be opening up your child's body, was trained and qualified for the work, right? You wouldn't be satisified with a mere promise from Scalpels 'R Us that "we guarantee that the work will be done right, and so you shouldn't concern yourself with *who* will actually perform the surgery."
- If things were to go wrong, you might well have the legal right to sue Scalpels 'R Us for monetary compensation (damages), but that might be small comfort if the surgeon's screw-up had permanently injured your child (or worse).

For similar reasons, services agreements often include requirements that the services be performed by individuals who are trained and qualified to do the work; see, e.g., [NONE]. A given project might not be as important as surgery on your child, but the expense and inconvenience of work gone wrong can still be a pain in the [neck].

#### 22.122.2 … and proxy evidence

Another reason to include a qualifications clause: If things did go wrong during your child's surgery, a jury might have a tough time judging whether or not the procedure had been performed correctly — but a qualifications clause such as this Clause provides an alternative "proof path" for the injured party: If it turned out that the surgeon didn't possess the necessary training, that would be its own breach of the contract, independent of whether the surgeon did or didn't do the work correctly.

## 22.123 **Pricing adjustment options**

The following terms apply only to the extent clearly so stated in the Contract. *[Suggestion for drafters: Copy and paste from the options below as desired.]*

### 22.123.1 Option: Pricing Adjustment Discretion

Supplier is not restricted in its ability to adjust its pricing, from time to time, in Supplier's sole discretion (see the definition in Clause 22.49).

### 22.123.2 Option: Pricing Cost Pass-Through

a. During the term of the Contract, if Supplier's relevant costs increase, then Supplier may pass the increase on — without markup — to Customer.

b. If Customer so requests, Supplier will provide Customer with reasonable supporting documentation that fairly evidences the increase in Supplier's relevant costs.

c. Customer will treat all documentation provided by (or for) Supplier under subdivision b above as Supplier's Confidential Information in accordance with Tango Clause 22.34 - Confidential Information

### 22.123.3 Option: Pricing Increase Limit

During the term of the Contract, Supplier will not increase the pricing it charges to Customer for transactions under the Contract: (i) more often than once per calendar year, nor (ii) by more than 20% for any given calendar year.

### 22.123.4 Option: Pricing Increase Notice

During the term of the Contract, Supplier will give Customer at least 30 days advance written notice of any pricing changes.

### 22.123.5 Option: Pricing Lock-In

During the term of the Contract, all pricing for transactions under the Contract will be as stated in the Contract.

### 22.123.6 Option: Pricing Generally-Applicable Increases

During the term of the Contract, Supplier will not increase the prices charged to Customer except as part of — and by a percentage no greater than the percentage of — a price increase to Supplier's customers generally for the same items.

## Clause 22.124 Privacy Law Definition

a. "Privacy Law" refers to any applicable law concerning the privacy, security, or processing of personal information,

including without limitation the law in jurisdictions where personal information was collected.

b. Privacy Laws include, without limitation, the following:

the California Consumer Privacy Act of 2018 ("CCPA");

the Children's Online Privacy Protection Act ("COPPA");

the Computer Fraud and Abuse Act ("CFAA");

the Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003 ("CAN-SPAM Act");

the Electronic Communications Privacy Act;

the European General Data Protection Regulation ("GDPR");

the Fair Credit Reporting Act ("FCRA");

the Fair and Accurate Credit Transaction Act ("FACTA");

the Family Educational Rights and Privacy Act ("FERPA");

the Federal Trade Commission Act;

the Gramm-Leach-Bliley Act ("GLBA");

the Health Insurance Portability and Accountability Act of 1996 ("HIPAA"), as amended and supplemented by the Health Information Technology for Economic and Clinical Health Act ("HITECH Act") of the American Recovery and Reinvestment Act of 2009;

the Telemarketing and Consumer Fraud and Abuse Prevention Act (TCFAP") ;

the Telephone Consumer Protection Act ("TCPA").

*Commentary*

This list is adapted from an underwriting agreement filed with the SEC effective Aug. 5, 2020, with a Form 8-K report by a company named "1847 Goedeker Inc."

## Clause 22.125 Prompt *(adjective)* Definition

*Prompt*, along with corresponding terms such as *promptly*, refer to taking specified action within a reasonable time and with a high priority, but not necessarily immediately nor with necessarily the highest priority.

*Commentary*

This term is of course vague, but it can be useful in requiring reasonably-fast action — but not necessarily immediate action — when the parties don't necessarily know (or perhaps can't agree on) a specific time frame for the action.

## Clause 22.126 Protected Group Definition

a. The term *Protected Group* relates to an individual or organization (a "*Protected Party*")

that is identified by name in an agreement

as being the beneficiary of a defense and/or indemnity obligation

or of a limitation of liability.

b. The term refers to the following:

1. the Protected Party itself;

2. the Protected Party's affiliates (see the definition in Clause 22.2), if any;

3. any other individuals or organizations specified in an agreement; and

4. for the individuals and organizations within the scope of subdivisions 1 through 3: their respective employees, officers, directors, shareholders (in that capacity), general- and limited partners, members, managers, and other persons occupying comparable positions, all as applicable.

c. As a hypothetical illustration, suppose that ABC Corporation is referred to by the shorthand term "ABC."

In that situation, the term "ABC Protected Group" would refer to ABC's Protected Group, as defined above.

*Commentary*

This is a convenience definition — the term *Protected Group* is used throughout the Tango Terms.

## Clause 22.127 Reasonable Efforts Definition

1. *Reasonable efforts* refers to one or more reasonable actions that together — at the time and in the circumstances in question — appear to be reasonably likely to achieve a stated objective.

2. A requirement to make reasonable efforts does not necessarily require taking every conceivable reasonable action.

3. Any assessment of reasonable efforts is to give due weight to the information reasonably available to the relevant person(s) at the relevant time, about, without limitation:

   a. the likelihood of success and the likely costs of particular actions and alternatives;

   b. the safety of individuals and property; and

   c. where relevant, the public interest.

4. In complying with an obligation to use reasonable efforts, the obligated party may give due consideration to its own lawful interests, including but not limited to avoiding putting itself in a position of undue hardship or incurring unduly-burdensome costs.

*Commentary*

This definition should be read in conjunction with the definitions of *commercially reasonable efforts* ([NONE]) and *best efforts* ([NONE]).

Subdivision a is intended to try to dissuade a court not to hold that *reasonable efforts* requires the making *all* reasonable efforts. (See also the commentary to the definition of *best efforts* at Section 22.20: .)

One UK trial court decision noted that "[a]n obligation to use reasonable endeavours to achieve the aim probably only requires a party to take *one* reasonable course, *not all of them* …."

Rhodia UK Ltd. v Huntsman Int'l LLC, 2007 EWHC 292 (Comm) ¶ 33 (emphasis added).

Consider a scenario in which Alice's contract with Bob requires Alice to make "reasonable efforts" to advise Bob in writing if some (non-emergency) Event X occurs. If Event X were to occur, then Alice might simply send Bob a quick email to that effect,

using the email address that Bob has consistently used in his dealings with Alice. In that scenario, many business people would think that Alice had complied with her contractual obligation to use reasonable efforts to advise Bob, even if for some reason Bob never got the email — and even if Alice did not duplicate the message by FAX, certified mail, etc.

Subdivision c.1: The terms "likelihood of success" and "likely cost" are inspired by a comment by Janet T. Erskine.

> See Janet T. Erskine, Best Efforts versus Reasonable Efforts: Canada and Australia (Lexology.com 2007).

Subdivision d: The "undue hardship" language above is adapted from the Janet Erskine comment cited in the commentary to subdivision c.1; the "incurring unduly-burdensome costs" is adapted from an email suggestion by now-retired Houston lawyer Stephen Paine, a friend and former colleague of the present author.

## Clause 22.128 Reckless Definition

a. A person (the "*actor*") acts *recklessly* when the actor: • consciously disregards • a substantial and unjustifiable risk • that harm will result • from the actor's conduct.

b. The risk of harm must be of such a nature and degree that —

considering the nature and purpose of the actor's conduct and the circumstances known to the actor —

the disregard of the risk involves a gross deviation from the standard of conduct with which a reasonable person would comply in the actor's situation.

*Commentary*

This definition is based on Model Penal Code 2.02(c), as implemented in, e.g., Tex. Pen. Code 6.03(c).

Some of the terms used, such as *substantial and unjustifiable risk* and *gross deviation*, are of course vague and likely to be the subject of debate.

## Clause 22.129 Record *(noun)* Definition

*Record*, in the context of documents and the like, refers to books, documents, and other data that are stored in any tangible- or intangible medium regardless of type, without regard to whether such items are in written, graphic, audio, video, or other form.

*Commentary*

This definition is adapted from the (U.S.) Federal Acquisition Regulations, Contractor Records Retention, 48 C.F.R. § 4.703(a).

## Clause 22.130 Recordkeeping

### 22.130.1 Introduction; parties

This Clause applies if and when, under the Contract, a party (a "*Recordkeeping Party*") must keep records.

*Commentary*

Many business dealings require parties to depend on information provided by other parties. For example:

- A commercial lease might require the tenant to pay not just a base rent, but also a percentage of gross revenue, which the tenant must periodically report to the landlord.

  See generally the Wikipedia article Percentage rent.

- A technology license agreement might require the licensee to pay the licensor a royalty computed as a percentage of the licensee's gross- or net sales involving the licensed technology, as reported periodically by the licensee.

  See generally the Wikipedia article Royalty payment.

In many such contract relationship, one party might want to propose that the other side: • keep specified records — in part because if a business is sloppy in its record-keeping, it *could* be a red-flag warning that the business is sloppy in other areas; • make periodic reports; and • provide copies of supporting documentation.

This manual doesn't include a *reporting* protocol, because the reports desired are very likely to be quite situational in nature. But if a client will want reports, its drafter can consider including custom-drafted provisions that address issues such as:

- how often a party must make *periodic* reports;
- what sorts of events could trigger a *nonperiodic* report;
- when are reports due, e.g., within X days after the end of a month, a quarter, a year, or some specified type of event;
- what information must be included in a report;
- whether any particular method is to be used to generate the reports, e.g., using specific auditing software to collect and summarize electronic data;
- whether reports must be certified, and if so:
  - what the certification should say;
  - who should "sign" the certification — this could be an internal certifier and/or an independent body such as an accounting firm;
- what if any supporting documentation must be provided with reports.

Drafters can consider also whether to propose:

- audit rights such as in Tango Clause 22.17 - Audits;
- inspection rights such as in Tango Clause 22.84 - Inspections Protocol; and/or
- periodic status /conferences, such as by incorporating Tango Clause 22.147 - Status Conferences.

### 22.130.2 Definition: Required Records

The term "*Required Records*" refers to records sufficient to document the following, when and as applicable:

1. all deliveries of goods and services under the Contract by the Recordkeeping Party to another party;

2. billing of charges or other amounts under the Contract by the Recordkeeping Party to another party;

3. all payments, by the Recordkeeping Party to another party, under the Contract,

of amounts not verifiable by the Recipient, such as, for example,

commissions, royalties, or rents to be paid to the other party as a percentage of the Recordkeeping Party's sales;

4. the Recordkeeping Party's relevant accounting procedures and practices; and

5. all other information (if any) that the Contract requires the Recordkeeping Party to report to another party.

*Commentary*

*22.130.2.1 Language origins*

This list of record categories is adapted in part from the contract in suit in an Eleventh Circuit case.

> See Zaki Kulaibee Establishment v. McFliker, 771 F.3d 1301, 1308 n.13 (11th Cir. 2014) (reversing, as abuse of discretion, and remanding district court's denial of plaintiff's request for an accounting).

Subdivision 4 (accounting procedures and practices) is adapted from Contractor Records Retention, 48 C.F.R. §§ 4.703(a).

*22.130.2.2 Alternative record-retention periods*

Some industries or professions might require specific record-retention periods.

Depending on the circumstances, a party might be required to keep, for example: Sales journals; purchase-order journals; cash-receipts journals; general ledgers; and inventory records.

*22.130.2.3 A more-detailed list of document categories*

A sample right-to-audit clause, published by the Association of Certified Fraud Examiners, contains a long "laundry list" of specific types of documents that a vendor might want to require a contractor to maintain:

> Such records shall include, but not be limited to, accounting records, written policies and procedures; subcontract files (including proposals of successful and unsuccessful bidders, bid recaps, etc.); all paid vouchers including those for out–of–pocket expenses; other reimbursement supported by invoices; ledgers; cancelled checks; deposit slips; bank statements; journals; original estimates; estimating work sheets; contract amendments and change order files; backcharge

> logs and supporting documentation; insurance documents; payroll documents; timesheets; memoranda; and correspondence.

This right-to-audit clause is archived at https://perma.cc/HP6G-LEAA.

### 22.130.3 Recordkeeping requirement

The Recordkeeping Party must cause the Required Records (see the definition in Clause 22.130.2) to be (i) made, and (ii) retained, in each case as stated in this Clause.

*Commentary*

This section establishes the basic requirement for recordkeeping.

### 22.130.4 Time period when records must be *made*

The Recordkeeping Party must cause records to be made and kept, as stated in this Clause, at all times during the term of the Contract.

*Commentary*

In some circumstances, contracting parties might want to narrow, or expand, the required time period for recordkeeping.

Note that the period for record *keeping* is distinct from the period for record-*retention*, which is addressed in [NONE].

### 22.130.5 Quality standards for *records*

The Recordkeeping Party must cause all Required Records:

1. to be accurate and materially complete;

2. to comply with at least commercially reasonable (see the definition in Clause 22.32) standards of recordkeeping; and

3. to comply with any stricter recordkeeping standards specified in the Contract.

*Commentary*

Subdivision 1: Some drafters use the term *true and correct*, but that seems both redundant and incomplete. Perhaps in an archaic sense the term *true* might be inter-

preted broadly to mean *materially complete and accurate*, but there seems to be little reason to take a chance that a judge would see it that way.

### 22.130.6 Record *retention* time and quality standard

The Recordkeeping Party must cause each of the Required Records to be retained,

in good condition,

for at least the longest of the following (the "*Record-Retention Period*"):

1. any retention period required by applicable law;

2. the duration of any timely-commenced audit (see § 22.17) of the Required Records that is permitted by the Contract, if any; and

3. such other period as is clearly specified in the Contract, if any.

*Commentary*

Parties might want to consider adopting the standard record-retention periods found in the [U.S.] Federal Acquisition Regulations.

See, e.g., Contractor Records Retention, 48 C.F.R. §§ 4.703(a)(1), 4.705. Some industries or professions might require specific record-retention period.

When services are involved, retaining records for two- to four years after final payment seems to be a not-uncommon requirement

Note that the period for record *retention* is distinct from the period for record-*keeping*, which is addressed in [NONE].

### 22.130.7 Option: Record Retention per FAR Standard

a. IF: This Option is agreed to; THEN: The Recordkeeping Party must cause each of the Required Records to be maintained for at least the period that the record would be required to be maintained under the (U.S.) Federal Acquisition Regulations ("FARs"), Contractor Records Retention, 48 C.F.R. Subpart 4.7.

b. Subdivision a is intended merely as a convenient shorthand reference in lieu of setting out the cited substantive record-retention terms;

the parties do not intend to imply or concede that the Contract and/or their relationship are in fact subject to the FARs.

*Commentary*

The FAR requirements for record-retention periods could be a useful benchmark. (It's not exactly a *neutral* benchmark, of course, because the feds want to preserve their audit rights.)

## Clause 22.131 Redlining

Each party's signature to the Contract constitutes a representation of that party's good-faith belief that it (or its counsel) has redlined, or otherwise called attention to, all of its changes in prior drafts of the Contract and related documents (exhibits, etc.) that it sent to any other party.

### Commentary

#### 22.131.1 Business context

When parties have negotiated a final draft of a contract or related documents, it's inconvenient and time-consuming to re-read the final document in its entirety before signing, merely to confirm that the other party did not surreptitiously make any unagreed changes — and that does sometimes happen, as discussed below. Most contract professionals know that:

- When revising documents sent over by the other side, all changes should be redlined or otherwise flagged.
- On a case-by-case basis, it can also be helpful to explain, in comments — for example, in Microsoft Word comment bubbles — the reasoning behind changes, to save time in negotiation conference calls.

#### 22.131.2 A canary-in-the-coal-mine clause

If a party (or, more likely, a party's lawyers) were to balk at agreeing to this certification, that could be a red flag that the party might not be a good business partner.

The other side might say, in effect, *we don't mind re-reading the entire document before we sign it*. You can then point out to your client that the other side obviously doesn't

mind wasting not only their money, but the client's, on unnecessary legal fees.

### 22.131.3 Why? Because surreptitious changes *do* happen

To be sure, the overwhelming majority of lawyers would never try to pull something so underhanded as to make surreptitious changes to signature versions of a document. Doing so could severely damage the lawyer's reputation and possibly even lead to disciplinary action.

But in a Sixth Circuit case, one party did just that, surreptitiously altering a release before signature.

> See Hand v. Dayton-Hudson, 775 F.2d 757 (6th Cir. 1985). The Sixth Circuit court affirmed the trial court's judgment reforming the release, that is, revising the release after the fact.

And a court might not come to the rescue; for example, a Russian court reportedly enforced a "contract" created by a man who changed a bank's credit-card agreement, then successfully sued the bank when it didn't comply with the altered terms.

> See Nick Shchetko, Russian Man Turns Tables on Bank, Changes Small Print in Credit Card Agreement, Then Sues, Minyanville.com (Aug. 7, 2013).

This type of sneaky behavior can happen even in what should be a relationship of trust and confidence: The author once served as an expert witness in a case in which a corporate officer surreptitiously altered his employment agreement, changing a two-*year* noncompetition provision to a two-*month* period. (The case was settled.)

And in a Delaware case, the court refused to declare that a $3.5 million payment obligation was unenforceable on grounds that it allegedly had been "quietly" inserted into settlement agreement.

> See Cambridge North Point LLC v. Boston and Maine Corp., No. C.A. No. 3451-VCS (Del. Ch. June 17, 2010).

This landlord could have used a redlining representation in its lease form: As a prank, a prospective tenant, reviewing the Word document of the lease form, inserted a requirement that the landlord must provide birthday cake on the weekend nearest the tenant's birthday. Understandably, the landlord didn't notice the insertion.

### 22.131.4 A redlining *rep* of good-faith belief, not a *warranty*

The certification in this Clause is merely a representation of good-faith belief, not a warranty. But it still gives each side an indisputably-reasonable basis for assuming that the other side isn't playing dirty in trying to slip in surreptitious changes. Each side therefore shouldn't have to worry that it must re-read the hard-copy document in its entirety before signing it.

(For "significant" contracts, it probably would still make sense to re-read the hard copy anyway, one last time.)

The specific wording is informed by the following thinking.

- At the end of a fiscal quarter, when a lot of sales contracts are in negotiation at once, negotiator time is a scarce resource that has to be used economically.

- A vendor's negotiator wants to provide as much legal protection for the vendor as practicable, but as the clock runs down on the quarter, the negotiator also want to try to timely get the customer's ink on the signature line — because there are other negotiations that also need attention.
- The customer's contract negotiator similarly has limited time, and might not be a lawyer.
- The last thing the vendor's sales people want is for the customer's negotiator to get nervous about the redlining language and, taking the path of least resistance, to put the deal aside until next quarter.
- In the author's experience, a representation clause comes across as "softer" than a warranty clause, and is less likely to trigger a visceral objection from the other side.
- True, a representation has different legal consequences than a warranty. (See XXX.) But in many vendor-customer situations — particularly longer-term, high-dollar relationships such as some software license agreements — the differences likely will be academic:
    - High-dollar vendors are keenly interested in preserving their customer relationships if at all possible — they generally don't want to file a lawsuit against a customer except as a last resort.
    - If a customer were *unintentionally* to make a material change in the contract without marking it, the odds are high that the vendor and customer would try to work things out amicably. In that situation, the mere existence of the representation clause would bestow a fair degree of moral- and bargaining leverage on the vendor. (It's something an in-house lawyer could bring to her counterpart and ask, "can't we do something about this?")
    - Whether the change in the contract was truly unintentional might well come down to the credibility of the customer's witnesses — not a comfortable situation for the customer to be in.
    - If a jury were to conclude that a customer had *deliberately* sneaked in a material unmarked change in the contract, that likely would be fraud under this representation clause — giving rise among other things to the possibility of punitive damages. That likely would give the vendor even more bargaining power in negotiations to fix the contract wording.

So, on balance, for high-volume, high-dollar, long-term agreements, this author prefers a simple representation that the customer is likely to accept readily, versus a more-complete warranty-and-reformation clause that might require more time for customer legal review.

That won't be the case in for all situations — and for an important, M&A-type deal, a tougher clause could well be superior — but for many cases, the softer approach seems to work pretty well.

# Clause 22.132 Referrals

## 22.132.1 Applicability; parties

This Clause applies if and when, under the Contract:

a specified party ("*Company*") is to pay another specified party ("*Associate*") commissions on Company sales

during a specified time period ("*Commissionable Sales Period*")

to otherwise-eligible customers in a specified territory and/or market segment ("*Territory*")

that are referred to Company by Associate during a specified time period ("*Referral Term*").

## 22.132.2 Schedule of business details

a. *Commission rate:* Commissions will be 0.001% of eligible sales.

b. *Eligible offerings:* All "Company offerings" are eligible for commissions; the quoted term refers to Company products and/or services that are —

offered for sale by Company,

in the Territory (defined below),

during the Referral Term (defined below).

c. *Territory:* The Territory for referrals is worldwide.

d. *Referral Term:* The "*Referrals Term*":

begins upon the effective date (see the definition in Clause 22.53) of the Contract; and

ends at the end of the day (see the definition in Clause 22.42) on the date two years after that;

in case of doubt: Only otherwise-eligible referrals made during the Referrals Term are eligible for commission payments.

e. *First-sale deadline:* For Associate to be entitled to any commissions for Company's sales to an otherwise-eligible referred customer,

> Company's first sale of a commission-eligible Company offering to that customer must be made on or before the date one year after Associate's initial referral of that customer to Company.

f. *Phase-out of commission right for a referral:* Company need not pay commissions for an otherwise-eligible sale to a customer if that sale is "made" (see [NONE]) after the end of one year after Company's *first* sale to that customer is made.

g. *Automatic extension of Referrals Term?* The Referrals Term will not be automatically extended unless the Contract unambiguously provides otherwise, in which case Tango Clause 22.58 - Evergreen Extensions will govern.

h. *Exclusivity?* Associate's referral rights are not exclusive unless the Contract unambiguously states otherwise, in which case Tango Clause 22.60 - Exclusivity will apply.

*Commentary*

The above details are placeholders that parties will most likely want to vary.

Note that under subdivision f, the due date for a commission payment might be after the end of this period.

### 22.132.3 When a Company sale is "made"

For commission purposes, an otherwise-eligible sale to a customer is considered "made"

> on the date that Company and the customer in question enter into a binding agreement for that sale,
>
> regardless of the putative effective date of that agreement.

*Commentary*

**Caution:** Be careful about using terms such as "*consummated*" sales — that led to what must have been an expensive lawsuit over a finder's fee: the court ruled that a finder's-fee agreement did not require the resulting federal contract to be "performed" in order for the transaction to be "consummated"; the finder's fee was therefore due and owing.

See Fed Cetera, LLC v. Nat'l Credit Servs., Inc., 938 F.3d 466 (3d Cir. 2019).

### 22.132.4 Confidentiality obligations

a. Associate will follow Tango Clause 22.34 - Confidential Information for any Company Confidential Information that Associate learns under the Contract.

b. Without limiting subdivision a: The terms of the parties' commission arrangement are Company's Confidential Information.

c. In case of doubt, Company need not treat any Associate information as Confidential Information unless the Contract unambiguously says so.

*Commentary*

In some cases, the parties might want to agree that Associate's Confidential Information will also be protected; see generally the discussion of the benefits of "two-way" confidentiality obligations in the commentary at Section 22.34.1.2: .

### 22.132.5 Associate performance requirements

a. The Contract may set forth minimum performance requirements for Associate.

b. If Associate fails to perform to those requirements, then (after any cure period specified in the Contract) Company may:

1. terminate Associate's right to receive commissions by notice; and/or

2. take such other action as may be specified in the Contract.

*Commentary*

Drafters can also consider specifying some kind of performance improvement plan, as provided in Tango Clause 22.121 - Performance Improvement Plan Protocol.

### 22.132.6 Payment of commissions; reporting; audits

a. *Due date:* Company will pay Associate commissions due under the Contract no later than 30 days after the end of the Company's fiscal quarter in which Company collects the associated invoiced price.

b. *Payment terms:* Tango Clause 22.120 - Payment Terms will govern payments due under this Clause. (For clarity: Associate need not invoice Company for the commissions due.)

c. *Reports:* With each commission payment, Company will provide Associate with a complete and accurate written statement of the amount(s) due, with reasonable supporting detail.

d. *Recordkeeping:* Company will keep records to support commission amounts due under the Contract in accordance with Tango Clause 22.130 - Recordkeeping.

e. *Audit right:* Associate may have Company's commission reports audited in accordance with Tango Clause 22.17 - Audits.

*Commentary*

This section provides an example of how parties can save time in drafting and legal review by incorporating varioius Tango Terms provisions by reference instead of negotating deal-specific language.

### 22.132.7 Specified sales are eligible for commissions

Associate will be eligible for commissions only —

on Company's sales of Commission-Eligible Offerings

to new customers that Associate refers to Company (each, a "*Prospect*"),

where each of the following requirements is satisfied:

1. The Prospect must have substantial operations in the Territory —

Company's determination of the substantial-operations question will be final and binding.

2. Associate must have referred the Prospect to Company during the Referrals Term.

3. The Prospect must not be barred by law from acquiring the Offering(s) in the Geographic Territory.

4. The Prospect must not be a competitor of Company

unless Company gives its prior written consent.

5. The Prospect must not have had a previous connection or relationship with Company

at the time of Associate's initial referral;

Company's determination of that point will be final and binding.

### 22.132.8 Excluded sales

Associate will not be eligible for commissions on any of the following:

1. separately itemized charges for taxes, shipping, and insurance; nor

2. a reasonable allowance for returns,

in accordance with Company's then-generally-effective return policy,

which is to be determined by Company in its sole judgment from time to time *but* is to be consistently applied.

### 22.132.9 Associate not Company's agent

Associate must not hold itself out as Company's agent unless the Contract unambigously states otherwise.

(See also Tango Clause 22.79 - Independent Contractors.)

### 22.132.10 Company control of customer sales negotiations

a. Associate's role (if any) in Company's sales negotiations with Prospects will be determined exclusively by Company in Company's sole discretion (see the definition in Clause 22.49).

b. Associate:

1. will follow Company's lawful directions in respect of Company sales negotiations; and

2. will not attempt to insert itself into any such negotiation without Company's prior approval.

#### 22.132.11 Responsibility for warranty claims

If a customer or other third party makes a claim (see the definition in Clause 22.29) against Associate

> because of what the third party alleges was a breach of a Company warranty about a Commission-Eligible Offering,
>
> then Company will defend (as defined in Clause 22.46) Associate's Protected Group (as defined in Clause 22.126) against the claim.

#### 22.132.12 Responsibility for alleged Associate faults

IF: A third party makes a claim (see the definition in Clause 22.29) against Company because of what the third party asserts was some fault on Associate's part, - of any kind;

THEN: Associate will defend (as defined in Clause 22.46) Company's Protected Group (as defined in Clause 22.126) against that claim.

## Clause 22.133 Reliance Waiver

#### 22.133.1 WAIVER of external representations

Apart from any representations set forth in the Contract itself — including but not limited to any materials incorporated by reference in the Contract —

> 1. no party has made any other representations to induce another party to enter into the Contract ("Other Representations");
>
> 2. no party is relying — nor *will* any party rely — on any alleged Other Representations; and
>
> 3. each party WAIVES any such reliance.

*Commentary*

See the extended discussion in Section 13.5: .

### 22.133.2 Knowing acceptance of risk

In making the waiver of [NONE], each party (each, a "Waiving Party") represents and warrants to each other party as follows:

1. the Waiving Party is capable — on its own behalf, and/or or through independent professional advice — of evaluating and understanding the terms, conditions and risks of this Agreement and the transaction(s) contemplated by this Agreement;

2. the Waiving Party understands and accepts those terms, conditions, and risks;

3. the Waiving Party intends for each other party to rely on the Waiving Party's disclaimer of reliance, and agrees that such reliance by the other party is reasonable.

*Commentary*

#### *22.133.2.1 Purpose*

This section contains "sound bites" to emphasize the waiver of reliance on undocumented representations.

#### *22.133.2.2 Language origins*

The above language is an example of "big boy" declarations in which parties aver, in essence: *We know what we're doing and are agreeing to particular terms with our eyes open*. It draws in part on a disclaimer that was successfully invoked by a bank.

> See Bank of America, N.A. v. JB Hanna, LLC, 766 F.3d 841, 856 (8th Cir. 2014) (affirming summary judgment in favor of bank). (Hat tip: Brian Rogers.)

See also [BROKEN LINK: freedom-k][BROKEN LINK: freedom-k][BROKEN LINK: freedom-k] (freedom of contract).

### 22.133.3 Advance release of certain future claims

The Waiving Party RELEASES each other party from any and all claims,

> by the Waiving Party or anyone claiming through the Waiving Party,

arising from the Waiving Party's reliance that is the subject of this Waiver.

*Commentary*

To "release" another party from a claim is, in essence, to withdraw the claim — "[t]he relinquishment or concession of a right, title, or claim …." Releases are generally used to get rid of *existing* claims, but some contracts include purported *advance* releases of *future* claims, using language along the lines above.

Release, Black's Law Dictionary (10th ed. 2014).

Drafters will want to check applicable law to determine whether the above **advance** release of claims concerning future events is enforceable.

See generally, e.g., Michael L. Amaro, Pre-Event Waivers and Releases - A Comparative Review of Current State Laws (PrindleLaw.com) (undated).

### 22.133.4 Advance waiver of certain California rights

The Waiving Party WAIVES the benefits (if applicable) of Section 1542 of the California Civil Code, which states: "A general release does not extend to claims that the creditor or releasing party does not know or suspect to exist in his or her favor at the time of executing the release and that, if known by him or her, would have materially affected his or her settlement with the debtor or released party.."

*Commentary*

In many respects, California law favors so-called "level playing fields," as exemplified by the above-cited statute.

**Caution:** This waiver of California law appears in some contracts, but the author has not researched the extent to which it's enforceable for *future* claims — it's possible that a California court might disregard this advance waiver as contrary to public policy.

## Clause 22.134 Representation Definition

1. *Implied assertion:* By making a representation, the representing party implicitly asserts:

a. that so far as the representing party knows at the time that the representing party makes the representation, the represented fact — as stated — is true; and

b. that the representing party has a reasonable basis for making the representation, *unless*, in the representation itself, the representing party limits the basis for the representation.

2. *Representing party's assent to reliance:* Whenever a party represents the truth of a matter in the Contract itself, the representing party should be understood as acknowledging that that any other party to the Contract (or, if so stated in the representation, a specified party) may rely — and is presumed to have relied — for a serious purpose, on both (i) the representation itself, and (ii) the representing party's assertion about its reasonable basis for the representation.

3. *New York choice of law for representations:* For uniformity: In any Agreement-Related Dispute (see the definition in Clause 22.3), any claim of misrepresentation — whether the representation was allegedly negligent, reckless, or intentional — is to be decided under the substantive law of New York, regardless what law might govern the dispute in other respects.

*Commentary*

Subdivision a.1: The phrasing, "so far as the representing party knows," is discussed at Section 13.6.2: and at § 13.7, paragraph 4.

Subdivision a.2: Note that this language places the burden on the representing party to *disavow* that it has a reasonable basis for its representation; see the additional discussion at Section 13.6.2: .

Subdivision b: Of course, in response to a claim of misrepresentation, the representing party should be allowed to try to show that, under the circumstances, it was unreasonable for the other party to rely on the representation. The reliance issue is discussed in detail at Section 13.3.3: ; see also the commentary below concerning the "serious purpose" element of proof under New York law.

Subdivision c: New York law is specified as a uniform gap-filler; the parties can of course specify a different law in the Contract. (See the commentary to § 22.4.3, relating to amendments, concerning the notion of choosing a law to govern a specific section of a contract.)

For claims of *negligent* misrepresentation:

> [u]nder New York law, the plaintiff must allege that[:]

> (1) the defendant had a duty, as a result of a special relationship *[which must be privity of contract or something close to it]*, to give correct information;
>
> (2) the defendant made a false representation that he or she should have known was incorrect;
>
> (3) the information supplied in the representation was known by the defendant to be desired by the plaintiff for a serious purpose;
>
> (4) the plaintiff intended to rely and act upon it; and
>
> (5) the plaintiff reasonably relied on it to his or her detriment.

Anschutz Corp. v. Merrill Lynch & Co., 690 F.3d 98, 114 (2d Cir. 2012) (granting motion to dismiss claim of negligent-misrepresentation; cleaned up, citations omitted, extra paragraphing omitted, bracketed italicized material added), *quoted in* Kortright Capital Partners LP v. Investcorp Investment Advisers Ltd., 257 F. Supp. 3d 348, 355 (S.D.N.Y. 2017) (denying motion to dismiss claims of negligent misrepresentation).

## Clause 22.135 Resale

Many products are not sold directly by their manufacturers, but indirectly via one or more layers of resellers. This Clause sets out basic provisions for reseller agreements.

*Note to drafters: See also the software-related terms in § 22.137 and the optional terms in § 22.136.*

Contents:

### 22.135.1 Introduction; parties

This Clause applies if and when, under the Contract:

a specified party ("*Reseller*"),

is to acquire and resell products and/or services,

of another party ("*Supplier*");

this arrangement is sometimes referred to as the "*Reseller Relationship*."

### 22.135.2 Gap-filler terms ###### [FIX THIS] ###

#### *22.135.2.1 Offerings; Territory; Resale Term*

Reseller may resell any and all Supplier products and/or services offered by Supplier in the Territory during the Resale Term, each as defined below (the "*Resale Offerings*"),

anywhere in the world, in all market segments (the "*Territory*"),

during the "*Resale Term*," which begins on the effective date of the Contract

and ends, if not sooner terminated in accordance with the Contract,

at the end of the day on the date two years later.

*Commentary*

Several of the gap-fillers here are unlikely to be agreed to IRL (In Real Life).

#### *22.135.2.2 Discount*

During the Resale Term, Reseller may acquire Resale Offerings from Supplier at a discount of 0.001% from Supplier's then-current, published list price that is applicable in the Territory.

*Commentary*

This discount level is extremely unlikely to be agreed to IRL (In Real Life).

#### *22.135.2.3 Payment terms*

Reseller's payments to Supplier for Resale Offering purchases are due net 30 days from Reseller's receipt of Supplier's invoice; [PH] will apply.

#### *22.135.2.4 No exclusivity*

The Reseller Relationship is nonexclusive unless the Contract unambiguously states otherwise, in which case [PH] will apply.

#### *22.135.2.5 Extensions of Resale Term*

Any extension of the Resale Term must be by affirmative mutual agreement unless the Contract unambiguously states that the Resale Term is "evergreen,"

in which case the Resale Term will be automatically extended,

for successive one-year extension terms,

unless either party opts out,

in accordance with [PH].

### 22.135.3 Cessation of resale activity upon termination

If and when the Resale Term expires or otherwise ends, Reseller will permanently cease:

a. advertising, marketing, or otherwise promote Resale Offerings; and

b. identifying itself as a channel associate of Supplier.

*Commentary*

It's not unheard of for a reseller to continue holding itself out as such notwithstanding that Supplier has terminated the reseller relationship. (The present author once had to deal with just such a situation on behalf of a client.) This section gives Supplier an explicit contractual requirement to enforce in such a case.

Subdivision 2 uses the term "channel *associate*" as opposed to the more commonly-used colloquial term "channel *partner*." That's because under U.S. law, members of a partnership might well be jointly and severally liable for each other's debts and liabilities incurred in the course of partnership business. Of course, a court might go along with the argument that "channel partner" doesn't mean that, but the wiser course seems to be to avoid the term *partner* instead of rolling the dice on what a given court might or might not do.

### 22.135.4 No subresellers without consent

a. Reseller may not appoint a subreseller without first obtaining Supplier's written consent.

b. Supplier may grant, withhold, or condition its consent to appointment of a subreseller in Supplier's sole discretion (see the definition in Clause 22.49).

c. Supplier's review and approval of a subreseller appointment will be solely for Supplier's benefit, not Reseller's.

*Commentary*

Supplier might not want to allow (what amounts to) multi-level marketing arrangements, so it will typically want to maintain some level of control over the appointment of subresellers, so that not just any individual or organization will be seen by the public as being associated with the supplier.

Subdivision c is intended to forestall claims by Reseller that Supplier should be liable for, e.g., negligence in approving a Reseller-proposed subreseller.

### 22.135.5 Subreseller information; background checks

When requesting Supplier's consent to the appointment of a prospective subreseller (a "prospect"), Reseller is to provide Supplier with the following:

a. the identity of the prospect;

b. evidence, satisfactory to Supplier in its sole judgment,

that the prospect has sufficient training and experience to carry out its duties as a subreseller

in a manner that will not reflect adversely on Supplier; and

c. such background information about the prospect as Supplier might reasonably request,

including but not limited to the results of a background check,

conducted in accordance with [PH],

if so requested by Supplier.

*Commentary*

Even though subresellers (usually) won't be designated as *agents* of Supplier, it's still the case that Supplier's reputation among the public could be affected by a subreseller's actions or inactions. Supplier might therefore want to do at least some due diligence on a prospective subreseller.

### 22.135.6 Subreseller agreement requirements

Each subreseller must enter into a written agreement with Reseller (a "*Subreseller Agreement*"); at a minimum, each Subreseller Agreement must:

a. impose at least the same restrictions and obligations on the subreseller as this Clause does on Reseller,

including prohibiting the subreseller from appointing sub-subresellers without Supplier's prior written consent on the same terms as in [NONE];

b. unambiguously state that Supplier will have no liability to the subreseller in connection with:

the Subreseller Agreement, or

the subreseller's dealing in Resale Offerings;

c. terminate automatically at the end of the Resale Term; and

d. unambiguously indicate that Supplier is a third-party beneficiary of the Subreseller Agreement.

*Commentary*

Supplier likely will want any subreseller, *vis à vis* Supplier, to be contractually bound to subsstantially the same restrictions and obligations as is Reseller.

### 22.135.7 Approval of form of subreseller agreement

a. Reseller must obtain Supplier's prior written approval of any form of Subreseller Agreement before using the form.

b. Reseller may redact those portions of the form of Subreseller Agreement that do not affect or relate to the matters stated in [NONE].

c. In case of doubt, Supplier's review of any such agreement form will be solely for Supplier's own benefit and not that of Reseller, the subreseller, or any other individual or organization.

### 22.135.8 Indemnity requirement

Reseller must defend (as defined in Clause 22.46) Supplier's Protected Group (as defined in Clause 22.126)

against any claim by a third party that arises out of acts or omissions of any party to a Subreseller Agreement,

other than a claim that the Contract unambiguously makes the responsibility of Supplier.

*Commentary*

Supplier won't want to be dragged into disputes between Reseller and its subresellers, so this section requires Reseller to handle any such disputes on its own.

**Caution:** As with any indemnity obligation, Supplier should consider requiring Reseller to maintain insurance as backup funding for the obligation.

### 22.135.9 Support for Reseller's customers

a. Level 1 support (defined in [NONE]) for Reseller's customers for Resale Offerings will be provided by Reseller.

b. Level 2 and Level 3 support will be provided by Supplier.

c. Reseller will follow any written- and oral guidance for customer support that Supplier causes to be provided to Reseller,

to the extent that such guidance is not inconsistent with the Contract.

d. Reseller will promptly notify Supplier if Reseller believes that it is unable to respond effectively to a particular request for support from a Reseller customer.

*Commentary*

A supplier will normally be quite interested in making sure that end-customers for the supplier's products are properly supported.

On the other hand, a supplier might well want at least some of the cost and burden of providing customer support to be taken on by resellers. (That could be a point to be negotiated along with the discount that the reseller will receive.)

### 22.135.10 Standard of Reseller performance

During the Resale Term, Reseller will use commercially-reasonable efforts (defined in [NONE]) in promoting sales of the Resale Offerings within the Territory.

*Commentary*

A supplier wouldn't want to appoint Reseller A and then get frustrated because Reseller A didn't seem to be working hard enough. In part, that's because the mere presence of Reseller A in the territory in question:

- would preclude the supplier from granting *exclusive* rights in the territory to another reseller; and
- might make it more difficult for the supplier to convince Resellers B, C, etc., to sign up as resellers for the supplier's offerings (because Resellers B, etc., might wonder whether the problem was with the supplier's offerings and not with Reseller A's performance).

Instead of using the vague requirement in this section, Supplier might prefer to bargain for more-specific performance requirements, as discussed in more detail in [BROKEN LINK: refer-mins-cmtry][BROKEN LINK: refer-mins-cmtry].

### 22.135.11 Consequences of Reseller nonperformance

If Reseller does not meet the performance standard set forth in [NONE],

then Supplier, in its sole discretion (see the definition in Clause 22.49),

may do one or both of the following:

1. invoke [PH], and/or
2. terminate the Reseller Relationship,

   either immediately

   or if Reseller does not achieve the goals specified in accordance with [NONE].

*Commentary*

Subdivision 1 above, which allows Supplier to put Reseller "on plan," gives the parties some flexibility in dealing with Reseller's failure to meet agreed performance goals — in many situations this will be a better approach than having Supplier's only choice be to terminate the Reseller Relationship.

(For more information about performance improvement plans, or "PIPs," see the commentary to [NONE].)

### 22.135.12 Pricing confidentiality

Reseller is to treat the pricing extended to Reseller by Supplier as the Confidential Information of Supplier in accordance with [PH].

*Commentary*

Chances are that Supplier won't want others to know what pricing discount is being given to Reseller.

### 22.135.13 Confidentiality of other Supplier information

Reseller is to preserve in confidence — also in accordance with [PH] — any other Confidential Information of Supplier to which Reseller obtains access.

*Commentary*

Supplier might also want to share other confidential information with Reseller, such as marketing plans, product roadmaps, and the like.

### 22.135.14 No agency unless unambiguously agreed

Unless the Contract unambiguously states otherwise, Reseller is not Supplier's agent,

and will conduct itself accordingly at all times.

*Commentary*

In some reseller relationships, the reseller is expected to act as the supplier's "agent" in the territory — but that can have significant legal consequences, such as:

- the reseller's having the legal authority to act in the name of the supplier (and make commitments that are binding on the supplier); and
- the supplier's potential liability for the reseller's actions and omissions.

So as the "default" position, this section rules out an agency relationship, but the parties are of course free to agree otherwise.

### 22.135.15 Public identification of relationship

During the Resale Term (see the definition in Clause 22.135.2) (and only then), each party (each, a "*Publicizing Party*") may:

a. publicly identify itself,

in a non-misleading way,

as, in effect, a channel associate of the other party, and

b. provide contact information for the other party:

(i) on the Publicizing Party's Website, and/or

(ii) in promotional materials approved in advance by the other party,

but only if the other party has either:

(x) made that contact information public, and/or

(y) authorized the Publicizing Party, in writing, to use the contact information.

### 22.135.16 Use of relevant trademarks as identifiers

a. A Publicizing Party's identification of itself as a channel associate under this Clause may include commercially-reasonable use (see the definition in Clause 22.32) use of the other party's relevant logos and other trademarks and service marks (collectively, "*Marks*");

except that Reseller may not use any Supplier marks other than those under which Supplier markets the Resale Offerings.

b. A Publicizing Party's use of another party's Marks must conform to [PH].

c. A Publicizing Party must promptly stop using another party's Marks upon any termination of the Reseller Relationship.

d. Nothing in this Clause gives either party any right in, nor any right to use, any Mark of another party except as expressly stated in this Clause.

*Commentary*

The odds are high that both Supplier and Reseller will want to promote sales of the Resale Offerings. Each party, however, will want to maintain control over its trademarks.

### 22.135.17 Equal warranty treatment of Reseller customers

Supplier will honor substantially the same Resale Offering warranty terms for Reseller's customers as Supplier does for its own customers of the same Resale Offering(s);

> Supplier, however, in its sole discretion (see the definition in Clause 22.49),
>
> may make any reasonable changes in warranty terms that it deems to be appropriate in view of territorial- or market differences, such as (for example) differences in applicable law.

*Commentary*

Both the supplier and the reseller should be concerned about how the reseller's customers will be protected by warranty coverage. This section:

- gives Reseller's customers essentially-equal status with Supplier's own customers; and
- precludes Reseller or its customers from claiming that Supplier must do *more* for Reseller's customers than for Supplier's own customers.

(The parties should consider what if any differences in warranty terms might be appropriate.)

### 22.135.18 Supplier's warranty indemnity obligation

Supplier will defend (as defined in Clause 22.46) Reseller's Protected Group (as defined in Clause 22.126) from any claim by any Reseller customer that acquired a Resale Offering from Reseller,

if the Reseller customer's claim arises out of an alleged breach of a Supplier warranty concerning the Resale Offering.

*Commentary*

This is a pretty-standard allocation of risk on this score.

As usual, Reseller might want to check out Supplier's financial ability to support this indemnity obligation, and possibly negotiate to have Supplier maintain one or more backup sources of funding for that purpose.

### 22.135.19 No Supplier warranty expansions by Reseller

Reseller will not purport to make (and has no authority to make), *on behalf of Supplier*, any commitment to any customer of Reseller except:

a. as publicly stated by Supplier in, for example (see the definition in Clause 22.59), Supplier's published marketing materials, end-user license agreement, terms of service, privacy policy, warranty document(s), etc.; and/or

b. with Supplier's express, prior, written consent.

*Commentary*

Under this section, Reseller can't change Supplier's warranties — but can Reseller offer *its own* warranties to its customers, as a kind of value-add? "Yes" is often a good answer; hence the next section:

### 22.135.20 Reseller's warranties to its customers

Supplier does not object to Reseller's offering Reseller's own additional warranties or other commitments to Reseller's customers that are more favorable to customers than those offered by Supplier, but —

a. If Reseller does so, it is at Reseller's own risk;

b. Reseller is to make it clear to its customers that Supplier is not liable for Reseller's commitments; and

c. Reseller must defend (as defined in Clause 22.46) Supplier's Protected Group (as defined in Clause 22.126)

against any third-party claim

arising from or relating to

any such additional warranty or other commitment offered by Reseller.

*Commentary*

In this section, note the phrasing "Supplier *does not object*." This phrasing was chosen to avoid any implication that Supplier is somehow "authorizing" Reseller's activity — conceivably such an implication might have downstream liability implications for Supplier if a Reseller customer were to sue Reseller for breach of Reseller's additional warranty and also sue Supplier on some kind of negligent-authorization theory.

### 22.135.21 Reseller modification of Resale Offerings

a. Reseller may not package, repackage, modify, or otherwise alter any Resale Offering without Supplier's prior written consent.

b. Supplier may grant or withhold such consent in its sole discretion (see the definition in Clause 22.49).

c. Supplier's review and, if applicable, its consent is for Supplier's sole benefit, and not for the benefit of Reseller or any other party.

*Commentary*

In some cases, Supplier won't really care whether Reseller modifies Supplier's goods — but such modifications could result in Supplier getting dragged into law-suits against Reseller by Reseller's customers.

Moreover, if Supplier owns intellectual-property rights in a Resale Offering, Supplier might not want Reseller creating "derivative works" without permission.

With that in mind, this section establishes a default rule under which Supplier must consent to Reseller modifications.

### 22.135.22 No Reseller opening of sealed packages

If any part of a Reale Offering comes to Reseller in a sealed package —

for example, a software license-code envelope —

then Reseller must not open the package.

### 22.135.23 No Reseller separation of components

IF: Any Resale Offering comes to Supplier in separable components;
THEN: Reseller must not separate the components.

### 22.135.24 No removal or alteration of legends

Reseller must not remove or alter any legend or notice,

for example, copyright- or trademark notices and the like,

and/or warnings or user instructions,

from any Resale Offering, promotional materials, or documentation.

### 22.135.25 Supplier's right to make changes

a. Supplier reserves the right — at any time and from time to time, in Supplier's sole discretion (see the definition in Clause 22.49):

1. to add to or delete from Supplier's line of offerings (defined below);

2. to modify any particular item in its line of offerings; and

3. to modify or discontinue support for any such item.

b. For this purpose, "line of offerings" includes, without limitation:

1. items that are part of the Resale Offerings, and

2. support for any such items.

*Commentary*

Some might assume that *of course* Supplier can make changes to its line of offerings — but creative lawyers for Reseller might try to argue that Supplier was somehow obligated to obtain Reseller's consent, which (cough) would come at a price. This section seeks to forestall such an argument.

### 22.135.26 Consultation with Reseller about changes

As a matter of commercial practice, Supplier may elect,

in its sole discretion (see the definition in Clause 22.49),

to consult or notify Reseller in advance of any changes that it makes to Resale Offerings (see [NONE]).

*Commentary*

The point of this section is to establish that Supplier's consultation with Reseller — if any — is within Supplier's sole discretion and not a matter of obligation.

### 22.135.27 No Seller liability for Resale Offering changes

Supplier will have no liability to Reseller for any change or changes that Supplier makes to Resale Offerings (see [NONE]),

whether or not Supplier consults with Reseller about the change (see [NONE]),

unless the change breaches an express requirement of the Contract.

*Commentary*

This section is intended as a roadblock against creative arguments that Supplier should compensate Reseller if Supplier decides to make changes to Resale Offerings.

#### 22.135.28 No Supplier control of Reseller's pricing

As between Reseller and Supplier, Supplier has no authority to determine the prices that Reseller charges to Reseller's customers.

*Commentary*

This section is intended to avoid any possible issues of resale price maintenance (a.k.a. vertical price fixing) under antitrust laws, as briefly discussed at [BROKEN LINK: channel-rpm-cmtry][BROKEN LINK: channel-rpm-cmtry].

## 22.136 **Resale - optional terms**

The following terms apply only to the extent clearly so stated in the Contract. *[Suggestion for drafters: Copy and paste from the options below as desired.]*

Contents:

### 22.136.1 Option: Data About Reseller Customers

a. Reseller will provide Supplier with data about Reseller's customers and transactions involving Resale Offerings as follows:

- from time to time, as reasonably requested by Supplier for purposes relating to the Reseller Relationship; and
- at the end of the Resale Term, as reasonably requested by Supplier to transition Reseller's customers to a relationship directly with Supplier.

b. Each party is to follow any restrictions imposed by law on the use and/or disclosure of customer data provided by Reseller.

*Commentary*

If Supplier has other ways of obtaining customer data from Reseller — e.g., software on-boarding; warranty registrations; frequent-user clubs; and the like — then Supplier might not need to get Reseller to commit to providing customer data.

### 22.136.2 Option Reseller's Marketing Obligations

Without limiting Reseller's other obligations under the Contract, Reseller will engage in the specific marketing efforts set forth in Schedule [FILL IN SCHEDULE NUMBER].

### 22.136.3 Option: Marketing Consultation

To reduce the chances of mutual interference between Supplier's and Reseller's marketing activities, Reseller will consult Supplier in advance about Reseller's own proposed marketing activities concerning Resale Offerings.

### 22.136.4 Option: No customers outside the Territory

Reseller will not solicit or support any customer for Resale Offerings if the customer has significant operations outside the Territory.

### 22.136.5 Option: No Reseller Facilities Outside the Territory

Reseller will not establish or maintain facilities specifically for supporting customers' use of Resale Offerings if such use is reasonably likely to occur outside the Territory.

### 22.136.6 Option: No Extra-Territorial Availability

Reseller will not make any Resale Offering available to any individual or organization if Reseller knows, or should know, that the Resale Offering will be taken, installed, or used outside the Territory.

### 22.136.7 Option: No Competition by Reseller

During the Resale Term and for one year thereafter, Reseller will not participate, nor acquire any interest, in any enterprise that offers or promotes a product or service that competes with any Resale Offering, *unless* Supplier gives its prior written consent.

### 22.136.8 Option: Minimum Reseller Inventory

Reseller will keep a minimum quantity of Resale Offerings in inventory as follows: *[DESCRIBE]*.

### 22.136.9 Option: Maximum Reseller Inventory

Reseller will not keep more than *[AMOUNT]* of Resale Offerings in inventory without Supplier's prior written consent.

### 22.136.10 Option: Reseller Retail Sales

Reseller may offer or sell Resale Offerings from physical premises (for example, in stores).

### 22.136.11 Option: No Reseller Retail Sales

Reseller will not offer or sell Resale Offerings from physical premises (for example, in stores) without Supplier's prior written consent

### 22.136.12 Option: No Other Resale Offering Sources

Reseller will not acquire Resale Offerings from sources other than Supplier.

### 22.136.13 Option: No Resale Offerings to Non-End-Customers

Reseller will not provide Resale Offerings to others for resale or redistribution.

### 22.136.14 Option: Reseller Delivery to its Customers

As between Reseller and Provider, Reseller is responsible for acquiring any physical Resale Offerings and — at its own expense and risk — arrange for all storage and/or delivery to Reseller's customers.

# Clause 22.137 Resale - software terms

Resale of software licenses involves some special issues, addressed in this OnContractDrafting.

Contents:



## 22.137.1 Introduction

This section applies,

as an addendum to [PH],

to any Resale Offering that includes

one or more types of license for the use of software (the "*Software*"),

including but not limited to licenses to use software-as-a-service, or "SaaS."

Contents:

### 22.137.2 Supplier customer-provisioning system

a. Supplier will provide one or more provisioning systems for Re-seller's customers to sign up for access to (and licensing of) the Software,

typically Web-based or as part of a Software installation routine.

b. Reseller is to refer all of its customers to such a Supplier-provided provisioning system.

### 22.137.3 Supplier license terms

a. Supplier may require Reseller's customers to agree to Supplier's then-current terms and conditions

as a prerequisite for being able to install and/or use the Software,

in Supplier's sole discretion (see the definition in Clause 22.49).

b. Such Supplier terms and conditions may include, without limitation,

1. applicable end-user agreement(s);
2. terms of service or -use; and/or
3. a privacy policy.

### 22.137.4 Reseller "push" of software updates

If Supplier releases a superseding version of a software Resale Offering —

including for example an update, patch, new release, supplement and/or add-on component,

then Reseller will promptly cause the following to be done:

a. notify all of Reseller's customers of the availability of the superseding version; and

b. encourage those customers to acquire and install the superseding version.

### 22.137.5 Reseller's authorized use [##### FIX #####] of the Software

#### *22.137.5.1 Categories of authorized use*

a. Reseller may use the Software — in executable form only — for purposes of:

1. demonstrations to prospective customers or clients;

2. testing; and

3. internal training for Reseller personnel concerning the Software.

b. All such use of the Software by Reseller must comply with Supplier's applicable terms and conditions (see [NONE]).

#### *22.137.5.2 Backup copies by Reseller*

Reseller may make a reasonable number of copies of the Software for purposes of backup, disaster recovery, and disaster testing,

in accordance with Reseller's normal IT procedures

in conjunction with Reseller's use of the Software under this section.

#### *22.137.5.3 No other use*

Otherwise, Reseller will not use the Software in any manner —

including, but not limited to, production use for Reseller's own benefit,

and/or service-bureau use for the benefit of any Reseller customer —

unless Reseller has obtained the appropriate license(s) from Supplier.

### 22.137.6 Reseller response to piracy, etc.

#### *22.137.6.1 Prompt notification to Seller*

a. IF: Reseller suspects that unauthorized use, copying, distribution, or modification of a Resale Offering (collectively, "Unauthorized Activities") might be taking place; THEN: Reseller must:

1. promptly advise Supplier; and

2. provide Supplier with all relevant information reasonably requested by Supplier about the Unauthorized Activities.

#### *22.137.6.2 Reasonable cooperation*

a. Reseller must provide reasonable cooperation with any "*Policing Efforts*" by Supplier, namely efforts to prevent or stop the Unauthorized Activities.

b. Whether Reseller's cooperation under subdivision a above is considered reasonable will depend (in part) on the following:

1. the likely expense of such cooperation, and

2. the extent to which Supplier agrees to bear that expense.

#### *22.137.6.3 No Policing Efforts by Reseller*

Reseller will not make any Policing Efforts of its own without Supplier's prior written approval.

### 22.137.7 Customer feedback

a. If Reseller receives any *written* feedback,

as defined in subdivision e,

concerning any Resale Offering,

at any time,

then Reseller will provide Supplier with a complete and accurate copy of the written feedback

within a reasonable time after Reseller receives it.

b. If Reseller receives any *oral* or other nonwritten feedback, concerning any Resale Offering, at any time,

then Reseller will brief Supplier orally about the feedback,

on a schedule to be determined by Supplier in its reasonable judgment.

c. Supplier may use or disclose feedback as Supplier sees fit in its sole discretion (see the definition in Clause 22.49).

d. Supplier will have no financial- or other obligation, of any kind, to Reseller or any of its customers, in respect of feedback,

unless expressly agreed otherwise in writing by Supplier.

e. For purposes of this section, "feedback" refers to any and all suggestions, comments, opinions, ideas, or other input.

### 22.137.8 What will Reseller do if Supplier issues any recalls?

a. Reseller will provide reasonable cooperation with Supplier and its designees in connection with any recall of Resale Offerings.

b. At Reseller's request, Supplier will reimburse Reseller for reasonable out-of-pocket external expenses,

such as, without limitation, shipping charges by independent carriers for returning physical Resale Offerings,

when actually incurred by Reseller in providing the cooperation required by subdivision a.

c. Reseller will make any request for reimbursement under subdivision b no later than three months after Reseller pays the relevant expense,

otherwise Reseller will be deemed to have WAIVED (see the definition in Clause 22.162) reimbursement of that expense.

### 22.137.9 What rules apply to Reseller's repairs, etc.?

a. This section applies if Reseller engages in repair or other servicing of Resale Offerings.

(This section, in itself, neither authorizes nor prohibits Reseller from engaging in such servicing.)

b. Reseller will use parts of equal or better quality than the original parts in the Resale Offering.

c. Reseller may not offer or provide as "new" any Resale Offering that Reseller has repaired after return by a customer.

### 22.137.10 Reseller may not rebrand any Resale Offerings

Reseller may not promote or offer Resale Offerings using any brand name or other trademark (including for this purpose service marks) other than those authorized in advance by Supplier.

### 22.137.11 Reseller is responsible for its business dealings

Reseller will defend (as defined in Clause 22.46) Supplier's Protected Group (as defined in Clause 22.126) from and against any and all claims by any third party arising out of Reseller's activities under an agreement.

### 22.137.12 Does Reseller get any other rights from Supplier?

No: Supplier reserves all rights not specifically granted by the Contract;

this reservation includes (without limitation) copyrights, patent rights, trademark and service mark rights, trade secret rights and other intellectual property rights.

### 22.137.13 This is not a franchise or business opportunity

a. This section applies unless the Contract clearly and unmistakably provides otherwise.

b. No party intends, by entering into the Contract, to create a relationship that would be subject to laws governing franchises and/or business opportunities.

c. Each party WAIVES (see the definition in Clause 22.162),

to the fullest extent not prohibited by law,

any rights or claims,

arising out of or relating to the Contract,

under laws governing franchises and business opportunities or similar laws.

*Comment — **caution:** In some jurisdictions, this clause will be unenforceable or even void; see, e.g., Cal. Corp. Code § 31512: "Any condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law or any rule or order hereunder is void."*

*Even so, language like this clause is sometimes seen in contracts.*

### 22.137.14 No Supplier responsibility for Reseller's finances

Reseller acknowledges (see the definition in Clause 22.1) that Supplier has no responsibility

for any dependence that Reseller's business might have on Resale Offerings,

nor for any harm that might come to Reseller from the Resale Term's coming to an end.

### 22.137.15 No termination at will

Neither party may terminate the Reseller Relationship at will unless the Contract clearly provides otherwise.

*Comment — alternative: "Beginning one year after the effective date of the Contract, either party may terminate the Reseller Relationship at will upon 30 days' notice in accordance with the termination-at-will provision in [NONE]."*

*If a party is going to have the right to terminate the Reseller Relationship at will, the other party should carefully consider putting appropriate "fences" around that right, so that the other party does not: • get caught unawares and left in the lurch, and/or • not be able to recoup its investment in the relationship. For more on this subject, see the commentary at [NONE].*

### 22.137.16 Termination will not* cut off Reseller's customers

In case of doubt: The ending of the Reseller Relationship will not affect any then-established rights or obligations of Reseller's customers concerning Resale Offerings.

*Commentary*

Reseller might want it "carved in stone" that Supplier won't abandon Reseller's customers after termination of the Reseller Relationship. (In many cases that should be a given: Supplier won't *want* to abandon Reseller's customers because Supplier will want to transition those customers into a direct relationship with Supplier or over to a different reseller.)

### 22.137.17 Closing of pending sales upon termination

IF: The Contract clearly says so; THEN: After termination of the Reseller Relationship,

Reseller may try to close any pending sales, as stated in [PH],

for five business days after the effective date of termination —

but not if the Reseller Relationship was terminated by Supplier for material breach (see the definition in Clause 22.102.2) by Reseller.

*Commentary*

This section might be a negotiation point.

### 22.137.18 Other terms to consider

The following terms are not part of this OnContractDrafting, but drafters can consider selectively incorporating one or more of the following terms by reference in the Contract:

[PH]

[PH]

## Clause 22.138 Responsible Definition

a. *Responsible*, in the sense of taking responsibility, refers to action that is both reasonable and conscientious.

b. As an illustrative example, to make *responsible* efforts to achieve an objective (whether or not the term is capitalized) means to make at least such efforts as a reasonable person would make in a conscientious attempt to achieve that objective.

*Commentary*

The term *responsible* is perhaps vague, but it's not unknown in the law. For example, the Delaware chancery court, in describing the duration of a preliminary injunction, referred to it as a "responsible period," albeit shorter than the period to which the claimant arguably would have been entitled.

See Martin Marietta Materials, Inc v. Vulcan Materials Co., 56 A.3d 1072, 1147 (Del. Ch. 2012), *aff'd*, 45 A. 3d 148 (Del. 2012) (en banc).

## Clause 22.139 Services

*Provisions whose headings begin with "Option:" do not apply in the Contract unless the Contract unambiguously states otherwise.*

Contents:

### 22.139.1 Introduction; parties

This Clause will apply when, under the Contract, a specified party ("*Provider*") is to cause services to be provided to, or for, another party ("*Customer*").

### 22.139.2 Signed, written statements of work required

a. If both parties have not signed an agreed written statement of work,

then Provider need not provide services under the Contract,

nor need Customer need not pay for services rendered.

b. For any statement of work, the parties' signatures may be in any way not prohibited by law,

including but not limited to email exchanges and other electronic signatures.

*Commentary*

Services agreements almost universally state that services will be rendered as set forth in an applicable statement of work. This is important, especially in high-dollar projects, to help make sure that the parties are (more or less) on the same page about *what* will be done, *when*, with what limitations and constraints (if any), and, crucially, for what cost, paid when.

How to write a statement of work is beyond the scope of this manual, but a Google search will reveal plenty of resources with tips for drafters. Consider searching, e.g., for "why should a services agreement include a written statement of work?" (link)

#### *22.139.2.1 Why written statements of work are important*

It can be risky to start work on a services project without having something in writing to nail down what will be done and how much is to be paid. Consider a California case about the *Fast & Furious* movies and a dispute about whether a producer was entitled to a percentage of the studio's earnings:

• Neal Moritz was a producer who worked for Universal Studios on the *Fast & Furious* series of movies, entered into a series of written contracts with the studio that covered "sequels" and "remakes."

• Moritz started work on the *Hobbs & Shaw* spinoff, which was *not* a sequel or remake. (The parties agreed that this was the case.)

• Moritz did this without a finalized written contract, just drafts that had been exchanged with the studio; the court recounted that:

> In the FAC *[first amended complaint]*, Moritz alleges that in connection with the Fast & Furious contracts, Moritz and Universal had fully negotiated and agreed upon an **oral** producer deal before any writings were exchanged, and that typically, Moritz would begin working on the production of the film prior to the oral producer deal being reduced to writing.
>
> Moritz alleges that this again occurred with respect to Hobbs & Shaw, but this time, Universal failed to honor the terms of the parties' oral agreement.

Moritz v. Universal City Studios LLC, No. B299083, slip op. at 6 (Cal. App. Sept. 2, 2020) (affirming denial of defendant's motion to compel arbitration in lieu of litigation) (cleaned up, emphasis and extra paragraphing added).

• The studio decided it didn't want Moritz involved, nor to pay him what he claimed was his customary first-dollar percentage.

• Moritz sued for breach of the alleged oral contract — and at this writing, it's unknown what the outcome of the case will be.

The parties likely could have avoided litigation altogether if they had *signed* even a very-short *written* agreement. The court noted that for the *Fast & Furious* movies 8 through 10, the parties' contract was less than two pages long because the contract simply adopted an earlier written contract with limited modifications.

See id., slip op. at 3.

For a few more examples of short contracts, see § 2.2.

#### *22.139.2.2 Who should sign a statement of work?*

Which party's signature should be required for a statement of work to be binding? The safest approach is to require signatures from both parties.

Concerning signatures, see generally the discussion of that topic in [NONE].

### 22.139.3 Changes to statements of work

a. Any change to statements of work will preferably be made in a writing signed by (at least) the party sought to be bound.

b. For pragmatic reasons, *oral* changes to statements of work are not ruled out, but an alleged oral change will not be enforceable unless clear and convincing evidence (see the definition in Clause 22.30) establishes that the parties in fact agreed to the change.

*Commentary*

As a project progresses, it's not uncommon for parties to want to change the statement of work; this section sets forth some ground rules to help avoid "he said, she said" problems on that front:

- A change is *required* to be signed only by the party that is purportedly bound by the change (borrowing from UCC § 2-201); and
- Bowing to business practicality, *oral* changes are permitted, but they must be proved up by clear and convincing evidence. (See generally Tango Clause 22.4 - Amendments and its associated commentary.)

Alternative:

> A change order must be agreed to by both parties.

This alternative borrows from the approach of UCC § 2-201, which requires that certain written contracts must be "signed by the party against whom enforcement is sought or by his authorized agent or broker."

### 22.139.4 Permits and licenses for the work itself

a. Provider is to timely obtain any permits and licenses that might be needed for performance of the services,

> for example, building permits; contractor- and occupational licenses; etc.

b. If Provider needs any special authorizations for the specific services,

then Provider will also obtain those authorizations unless the Contract clearly says otherwise.

*Commentary*

*22.139.4.1 Business context*

In some cases, the law might require —

- an occupational license for a service provider, e.g., a contractor license; and/or
- a permit for specific work itself under the parties' business plan, e.g., a building permit.

*22.139.4.2 Caution: Doing unlicensed work can be costly*

Imagine that you're a service provider. Now imagine that for a particular project, you don't have *all* your required licenses and permits in place, at *all* times. That could give your customer the legal right to "stiff" you — and even to demand that you repay money you've already been paid.

• For example: Under a California statute, a contractor might **forfeit** its right to be paid if it undertakes work required to be done by a licensed contractor (e.g., certain construction- or remodeling work), but does not itself have the proper license(s) at all times while performing the work.

*Example:* In one case, a subcontractor had not obtained the required license when it prepared initial shop drawings and did other preliminary work. In the trial court, the subcontractor won a judgment for more than $220,000 in unpaid invoices, but on appeal the subcontractor lost because it hadn't been licensed *while doing the preliminary work*. See Great West Contractors, Inc., v. WSS Industrial Construction, Inc., 162 Cal. App. 4th 581, 76 Cal. Rptr. 3d 8 (2d Dist. 2008), applying Cal. Bus. & Prof. Code § 7031.

• Moreover, under a 2002 'disgorgement' amendment to the California statute, such a contractor might have to **repay** any payments it did receive for the work.

Cf. The Fifth Day, LLC v. Bolotin, 72 Cal. App. 4th 939 (2d Dist. 2009) (reversing summary judgment that party was barred from recovering compensation for services; party was not a "contractor" within the meaning of the statute).

• A Tennessee statute is to similar effect but is less draconian: "Any contractor required to be licensed under this part who is in violation of this part or the rules and regulations promulgated by the board shall not be permitted to recover any damages in any court other than actual documented expenses that can be shown by clear and convincing proof."

Tenn. Code Ann. § 62-6-103(b) (2016).

*22.139.4.3 Should Customer obtain particular permits?*

Some types of work might need specialty permits or licenses — as a made-up example, suppose that Provider is to paint a room, but the room is part of the intensive-

care unit at a hospital, and that type of work require a special authorization from health authorities. (Again, this is just a made-up example.)

As a default, [NONE] requires the service provider to obtain those permits and licenses — even in such specialty cases — but that might be a point for negotiation.

### 22.139.5 Permits and licenses for use of deliverables

Customer is to timely obtain any licenses or permits needed for *use* of deliverables by Customer or others authorized by Customer,

> for example, any necessary patent licenses and/or government permits.

*Commentary*

#### *22.139.5.1 Business context*

In any services contract, both the provider and the customer should give some thought to whether any third-party authorizations might be needed for the customer to be able to *use* the deliverables.

#### *22.139.5.2 Patent licenses for use of deliverables?*

Services contracts sometimes include a warranty by the provider that, in performing the services, the provider will not infringe any third party's intellectual-property rights. The provider might even warrant that *the deliverables* themselves do not infringe third-party IP rights. And under the (U.S.) Uniform Commercial Code, a merchant seller of *goods* (not services) implicitly warrants the goods' noninfringement:

> (3) Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like ….
>
> UCC § 2-312; see also the discussion at Section 2.9.2: concerning who is a "merchant."

But such provider warranties might not protect the customer from third-party infringement claims arising from the customer's *use* of the deliverables, which is a distinct issue. *Example:* Under U.S. patent law, *use* of a patented product or method, without permission of the patent owner, would infringe the patent:

> (a) Except as otherwise provided in this title, whoever without authority makes, **uses**, offers to sell, or sells any patented invention, within the United States or imports into the United States any patented invention during the term of the patent therefor, infringes the patent. * * *
>
> (g) Whoever without authority imports into the United States or offers to sell, sells, or **uses** within the United States a product which is made by a process

> patented in the United States shall be liable as an infringer, if the importation, offer to sell, sale, or use of the product occurs during the term of such process patent. …
>
> 35 U.S.C. 271 (emphasis added).

For that matter, the responsibility for infringement might even rest with the customer, not the provider, because the rest of UCC § 2-312(3) provides as follows:

> (3) … a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications.
>
> UCC § 2-312(3).

#### *22.139.5.3 Other licenses for use of deliverables?*

As one hypothetical example, suppose that a service provider is a pharmaceutical laboratory that is licensed to manufacture controlled substances such as opioids. It might be perfectly legal for the lab to whip up a custom batch of an opioid-based medication for a physician, but in the U.S., the physician would need to be state-licensed to practice medicine and federally-licensed to dispense controlled substances.

See generally, e.g., Maureen Malone, How to Obtain a DEA License for Physicians (Chron.-com, undated).

#### *22.139.5.4 Violation of law by use of deliverables?*

It should be apparent that a services provider can't necessarily warrant that the customer's use of deliverables won't violate applicable law.

*Example:* Suppose that a freelance software developer is engaged by a customer to write a computer program that scans the customer's network in search of security gaps.

- Such a computer program might also be usable for nefarious purposes — most obviously, scanning someone else's network in an attempt to break in.
- It follows that the software developer would not want to warrant that *the customer's use* of the computer program would not infringe any third-party rights.

### 22.139.6 Disagreement about need for authorization

IF: Provider and Customer disagree about the need for a particular third-party authorization;

THEN:

1. Provider will not be in breach of the Contract if, with prompt notice (see the definition in Clause 22.112) to Customer, Provider suspends the relevant work until the parties resolve the disagreement; and

2. the parties are to attempt to resolve their disagreement in accordance with [NONE].

*Commentary*

It's possible that: • a service provider might believe that the provider must get a particular third-part authorization (for example, a patent license) to perform some part of a project; • the customer disagrees — or perhaps the customer agrees but says *I don't want to take the time or pay the cost of getting the authorization, so get started!*

In that scenario, the provider might justifiably be concerned about its own potential liability; this section provides a way of addressing the concern.

### 22.139.7 Consequences of failure to obtain authorizations

a. If a party fails to obtain a particular permit or license as required by the Contract,

> and as a result, a third party makes a claim against another party to the Contract,
>
> then the first party must defend and indemnify the other party and its Protected Group (see the definition in Clause 22.126) against all foreseeable damages and losses arising from the third party's claim.

b. As an illustrative example, such a claim could include (without limitation) a customer's being directed, by a government authority, not to use a deliverable because of a failure to obtain a permit that a service provider was responsible for obtaining.

*Commentary*

Not getting the proper permits can cause problems. *Author's note:* As one personal example, years ago my wife and I moved into a brand-new house that we'd had built, along with our new baby plus my wife's parents (who'd come to town to help). The very next day, we had to move out and into a hotel: The builder's inexperienced ~~foreman~~ construction supervisor had neglected to have the city do the required final inspection. We had to stay in the hotel for several days — at the builder's expense, of course — until the inspectors could find time to do the inspection.

For that reason, this section provides a gap-filler concerning who is to bear the resulting costs in case something like that should happen.

*Note to students:* Suppose that my wife's and my contract with the builder was silent about this situation — which it probably was (I haven't dug it out to look).

QUESTION: Would our hotel bill have been "consequential damages" that could have been excluded by agreement? See generally the discussion in the commentary at [NONE].

### 22.139.8 Qualifications of assigned personnel

Provider is to see to it that, at all relevant times, the requirements of Tango Clause 22.122 - Personnel Qualifications are met by each individual who performs services under a statement of work.

*Commentary*

See generally the commentary at Tango Clause 22.122 - Personnel Qualifications.

In some circumstances, drafters might want the Contract to include specific personnel qualifications in the statement of work.

### 22.139.9 Background checks for certain personnel

If the statement of work clearly so states, then Provider is to cause background checks to be performed in accordance with Tango Clause 22.18 - Background Checks on all non-Customer personnel who, under the statement of work, will do any of the following:—

1. providing services while physically on-site at Customer's site;
2. having access to Customer confidential information — including but not limited to protected health information of Customer's customers or patients;
3. interacting with Customer's customers; and/or
4. having access to Customer's computers or network.

*Commentary*

See also Tango Clause 22.18 - Background Checks and its commentary.

Sometimes service providers will be gaining access to very-sensitive customer information, or to vulnerable customer facilities. Often in those situations the customer will want to require background checks on the relevant service-provider personnel.

This section doesn't *mandate* background checks for *all* statements of work; instead, it allows for background checks on a case-by-case basis.

### 22.139.10 Professional (i.e., workmanlike) performance required

a. Provider is to see to it that all services are performed in a "professional" manner, which refers to work that is performed:

> by people who have the knowledge, training, and/or experience necessary for the successful practice of the relevant trade or occupation; and
>
> in a manner that is generally considered proficient by those capable of judging such work.

b. If the Contract uses the term *workmanlike*, the term has the same meaning as *professional* as defined above.

*Commentary*

*22.139.10.1 Drafting note*

This Clause is phrased as a *covenant*, that is, a promise, and not a representation (see the definition in Clause 22.134) or warranty (see the definition in Clause 22.163) – although, to be sure, a warranty *is* a type of covenant, specifically a conditional covenant.

> See Black's Law Dictionary at 1725 (9th ed.2009), *quoted in* Fed. Ins. Co. v. Winter, 354 S.W.3d 287, 293 (Tenn. 2011).

*22.139.10.2 "Professional" = workmanlike*

This Clause uses the term *professional* instead of *workmanlike* because the former term sounds more, well, professional. But it also *defines* the term *professional* by borrowing from the Supreme Court of Texas's definition of *workmanlike*.

> See Melody Home Mfg. Co. v. Barnes, 741 S.W.2d 349, 354 (Tex. 1987), *quoted in* Ewing Constr. Co. v. Amerisure Ins. Co., 420 S.W.3d 30, 37 (Tex. 2014) (responding to certified question from Fifth Circuit).

In subdivision a, the phrase "without necessarily rising to the level of being exceptional, outstanding, or original" is adapted from an alternate definition of *workmanlike* in the Merriam-Webster dictionary, namely "competent and skillful but not outstanding or original."

> See workmanlike (Merriam-Webster.com) (alternate definition).

*22.139.10.3 Implied warranties of "workmanlike" performance?*

Drafters should be aware that in some states the law might *automatically impose* a warranty of workmanlike performance, or something close to it.

> See, e.g., Fed. Ins. Co. v. Winter, 354 S.W.3d 287, 291-94 (Tenn. 2011) (citing numerous authorities but not defining *workmanlike*).

Implied warranties of workmanlike performance come into play especially in connection with the sale of a new residence. The imposed warranty might even be non-waivable and/or non-disclaimable. For example:

- *Home construction:* Forty-three states provide an implied warranty of habitability for new residences, according to the Utah supreme court, while three others provide a warranty of workmanlike manner.

  See generally Davencourt at Pilgrims Landing Homeowners Association v. Davencourt at Pilgrims Landing LC 30, 2009 Utah 65, 221 P.3d 234, 250 (reversing dismissal of implied-warranty claim; "in every contract for the sale of a new residence, a vendor in the business of building or selling such residences makes an implied warranty to the vendee that the residence is constructed in a workmanlike manner and fit for habitation").

- *Repairs of tangible goods or property:* In its *Melody Homes* decision, cited above, the Texas supreme court held that an implied warranty of good and workmanlike performance extends to repairs of tangible goods or property. But two sharp dissents (in the form of concurrences in the judgment) noted that the court had defined that implied warranty in a manner that might well require expert testimony in many cases (but that would seem to be true of almost any standard of performance of services).

  See also the commentary at Section 13.4: .

#### *22.139.10.4 Alternative performance standards?*

Some service providers might balk at using the term *professional* or *workmanlike* performance because they fear the term could be ambiguous; these providers might prefer *in accordance with the specifications*, or perhaps *competent and diligent*.

Of course, *any* of those terms is likely to involve factual determinations in litigation or arbitration, so it's hard to see how one is more- or less favorable than the other.

On the other hand, some customers prefer stricter standards of performance such as, for example:

- *In accordance with industry standards:* This phrase and *professional* (or *workmanlike*) seem synonymous, in which case *professional* is more likely to find acceptance among customers.
- *In accordance with the highest professional industry standards:* For a provider, this is the worst of all worlds: Not only is the phrase vague, but a provider that agrees to this might as well hang a "Kick Me" sign on its own back, because anything less than perfection would be open to cricitism in court. (On a related note, see also the discussion of best efforts (see the definition in Clause 22.20).)

#### *22.139.10.5 Further reading (optional for students)*

See generally, e.g.: • J. Norman Stark, "Workmanlike Manner," Defined (Lorman.com, undated) (citing a few cases); • Timothy Davis, The Illusive Warranty of Work-

manlike Performance: Constructing a Conceptual Framework, 72 Neb. L. Rev. (1993).

### 22.139.11 Provider's responsibilities

Unless the Contract or the statement of work unambiguously provides otherwise, Provider must see to the performance of the following:

1. the successful completion of all individual tasks and other actions necessary for the proper rendering of the services as set forth in the statement of work,

    even if one or more such individual tasks is not expressly set forth in the statement of work;

2. the timely furnishing of: —

    all materials, equipment, supplies;

    computer hardware and -software;

    work locations;

    electrical power;

    Internet- and other communications capabilities;

    prudent, properly-functioning safety equipment

        for Provider's personnel

        and for the personnel of Provider's contractors,

        including, without limitation, any necessary personal protective equipment (PPE);

    and other items needed to meet Provider's performance responsibilities;

    this obligation includes any necessary acquisition, installation, and maintenance of all such items; and

3. all supervision and, to the extent necessary, training of all individuals engaging in the services.

*Commentary*

When a customer hires a service provider, the customer generally wants the provider to "just handle it." The customer normally doesn't want to be asked by

workers, "hey, do you happen to have a ballpeen hammer," or "would you mind doing X," and so on — *unless* the customer has agreed in advance, in the statement of work, that *the customer* will handle those aspects instead of the provider.

(Of course, for some projects, it might make sense for the customer to provide some of the listed items. If so, that should be documented in the statement of work.)

Some customers thus might want language like [NONE] for comfort purposes. A provider *might* be concerned that such language could lead to disputes about expensive (and delay-causing) "scope creep"; the author's guess, though, is that this language wouldn't do any significant harm — here's why:

- Suppose the parties were to end up fighting about the scope of what the provider is supposed to do.
- In that case, the presence or absence of this language seems unlikely to make a difference one way or the other.
- So, if this language gives a customer some comfort, why not include it, because doing so could help to remove a potential delay on the path to signature.

### 22.139.12 Provider control of means and manner of work

In case of doubt: As between Provider and Customer, Provider has the sole responsibility for controlling the means, manner, time, and place of performance of the services.

*Commentary*

Some services agreements state explicitly that the services provider is responsible for controlling the means and manner of the work. Typically, that's to try to bolster the argument (by the customer, usually) that the service provider is truly an independent contractor, as opposed to a customer employee. See generally the discussion at [BROKEN LINK: indep-k-top][BROKEN LINK: indep-k-top][BROKEN LINK: indep-k-top].

### 22.139.13 Customer cooperation responsibility

a. Customer is to provide reasonable basic cooperation with Provider,

and with Provider's agents and subcontractors, if applicable,

as reasonably requested by Provider from time to time.

(Note: This section is not intended to implicitly authorize the use of subcontractors, but it does not prohibit such use either.)

b. Subdivision a, however, is not intended to diminish Provider's responsibilities for accomplishing the services called for by the statement of work.

### 22.139.14 Defect handling

In any case of defective performance of services and/or delivery of defective deliverables, Provider is to proceed in accordance with Tango Clause 22.45 - Defect Correction.

### 22.139.15 Payment for services

a. Provider is to invoice Customer, and Customer is to pay Provider, for services in accordance with the applicable statement of work.

b. If the statement of work does not specify when invoices and/or payments are due, then Provider is to invoice Customer, and Customer is to pay Provider, for services:

1. one-half upon agreement to the statement of work, with payment for that invoice being due upon receipt; and
2. the balance upon completion and acceptance of the services.

*Commentary*

When should payment for services be due? Generally speaking, both service providers and customers want payments to be scheduled so as to reduce their downside risk in case the other side fails to deliver:

- A provider, of course, will want to be paid as soon as possible —
  - with the customer paying some portion of the money up front to cover the provider's expenses, so that the provider won't have to put its own cash at risk; and
  - with the customer making interim progress payments as milestones are achieved, so that the provider can stop work if the customer doesn't pay.
- A customer, on the other hand, would prefer to hang on to its money until the provider has finished its work — and perhaps even longer, to be sure that the provider fixes any glitches that arise after completion.

The statement of work will often specify the payment schedule, but in case that doesn't happen, [NONE] provides a simple compromise rule as a gap-filler.

### 22.139.16 Expense reimbursement

Customer need not reimburse Provider for expenses incurred in performing services unless the Contract unambiguously says so.

*Commentary*

Services providers generally incur expenses such as materials, rental of specialized equipment, and the like. Some statements of work might call for the provider to bill those expenses to the customer, but other, "total price" statements of work might require the provider to absorb those expenses as part of the provider's fee for services.

### 22.139.17 Suspension of services for nonpayment

IF: Customer does not pay Provider an amount due under the Contract within seven days following the original payment due date,

> and the nonpayment is not clearly due to fault attributable to Provider,

THEN:

> 1. Provider may suspend its performance of the relevant services at any time beginning at the end of seven days following the effective date of Provider's notice to Customer of upcoming suspension; and
>
> 2. Any such suspension will be without prejudice to Provider's other remedies for the nonpayment.

*Commentary*

If a customer doesn't pay a service provider's invoice, the provider's main *practical* leverage might be to stop work. (If the unpaid amount due is large enough for the nonpayment to constitute a material breach, then the provider might well be entitled to stop work even if the contract doesn't say so, as discussed in Tango Clause 22.102.2 - *Material breach* definition.)

But sometimes the service in question might be critical to the customer's operations, in which case the customer might want to prohibit the provider from suspending the services without "due process" such as notice and an opportunity to cure.

Examples of such mission-critical services might include so-called software as a service ("SaaS"); cloud computing services such as Amazon Web Services ("AWS"); and employee-management services such as those provided by Insperity.

### 22.139.18 Customer audit of Provider's payment-related records

a. If the relevant statement of work states that the services are to be provided (i) on a time-and-materials basis, and/or (ii) on a cost-plus basis,

> then Provider will keep records in accordance with Tango Clause 22.130 - Recordkeeping,
>
> and Customer may audit those records in accordance with Tango Clause 22.17 - Audits.

b. Otherwise, Provider need not allow Customer to audit Provider's records concerning the services unless the Contract clearly says otherwise.

*Commentary*

A statement of work might be set up on a time-and-materials basis — that is, the service provider bills the customer a specified amount per hour for the time that the provider's personnel spend, plus the cost of any materials required — or on a cost-plus basis. In that situation, the customer might want the right to audit the provider's books and records to provide some comfort that the provider isn't over-billing the customer.

See, e.g., Time and materials (Wikipedia.com); Cost-plus pricing (Wikipedia.com).

### 22.139.19 No *implied* confidentiality obligations

Neither party has any confidentiality obligations relating to the services unless the Contract and/or the statement of work unambiguously says so.

*Commentary*

In some services agreements, the provider might gain access to confidential information of the customer itself or the customer's own customers. The provider might also gain access to personal information that's legally protected under applicable privacy law.

On the other side of the coin: In some services agreements, the *customer* might gain access to confidential information of the *provider*, e.g., in the form of the provider's proprietary computer software or data.

Alternative:

> Provider will preserve in confidence the Confidential Information of Customer in confidence per Tango Clause 22.34 - Confidential Information.

Or:

> Each party will preserve in confidence the Confidential Information of the other party per Tango Clause 22.34 - Confidential Information.

### 22.139.20 No further payment to Provider for *use* of deliverables

IF: Provider has any legal right to restrict Customer's use of deliverables,

for example under a patent or copyright;

THEN: Provider will not object to Customer's use — in whatever manner that Customer sees fit —

of any deliverable resulting from services under the Contract,

without additional compensation to Provider, in any form,

unless the Contract or the statement of work clearly says otherwise.

### 22.139.21 Further development not prohibited

Unless unambiguously agreed otherwise in writing,

Provider will not object to Customer's doing any of the following:

modifying or otherwise continuing development of any deliverable, and/or

having the same done by others on behalf of Customer,

but in any such case, only in accordance with this section.

*Commentary*

A customer that hires a provider to build something generally won't want to be tied down to using the same provider to improve- or build on it.

But doing so might violate the provider's intellectual-property rights, e.g., if building on the provider's work product constitutes creating a "derivative work" of a copy-

righted work of authorship created by the provider.

To flag this issue for possible discussion during contract negotiations, this section explicitly authorizes such improvements.

### 22.139.22 No Provider support obligation

Except as provided in [NONE],

Provider may, in its sole discretion (see the definition in Clause 22.49), decline to provide support for a deliverable

if Provider reasonably determines that the request for support

arises from, or relates to, modification of the deliverable

by any individual or organization other than Provider.

*Commentary*

From a provider's perspective, it only makes sense to disavow any *binding obligation* to support further development of the provider's deliverables by others, because —

- the other developers could easily screw things up;
- the provider might prefer that *it* be paid for futher development; and
- the provider might be concerned about revealing the provider's trade secrets to other developers.

### 22.139.23 Exception: Provider support required

[NONE] will not apply to the extent — if any — that Provider has:

a. expressly and in writing, authorized or directed the particular modification in question, and

b. committed in writing to support the modification.

*Commentary*

This section is mainly a reminder, with suggested ground rules for provider agreement to additional support.

### 22.139.24 Compliance requirements for further Customer development

Any deliverable-related modification- or development activity,

by or on behalf of Customer,

under this section must not violate:

a. applicable law such as export-controls laws; nor

b. any unrelated rights assertable by Provider (for example, intellectual-property rights), if any, nor

c. any additional restrictions umambiguously agreed to in writing.

*Commentary*

Subdivision 2: Sometimes customers want to be able to refine or improve a service provider's deliverable, but doing so might infringe the provider's rights. *Example:*

- Suppose that a company hires a Web developer to build an interactive Website for the company to use with the company's own customers.
- Once the Website is complete, the company might well want the right to have other developers make necessary changes as time goes on, instead of being leashed forever to the original provider.

On the other hand, the service provider might not want to have to provide ongoing support for a deliverable if the customer itself, or a third party, has been "improving" the deliverable.

### 22.139.25 Termination of a statement of work for breach

Any party may terminate a statement of work for material breach (see the definition in Clause 22.102.2) by the other party,

effective immediately upon notice of termination to the other party,

if both of the following prerequisites are satisfied:

a. The terminating party gives the breaching party notice (see the definition in Clause 22.112) that specifies the breach in reasonable detail; and

b. Before the end of five business days after the effective date of the notice of breach, either or both of the following have *not* occurred:

(i) cure of the breach, and

(ii) effective notice from the breaching party, accompanied by reasonable supporting evidence, informing the terminating party of the cure.

*Commentary*

Termination of a statement of work *for breach* is a fairly straightforward proposition: The other party gives notice of the breach and (in most cases) an opportunity to cure, followed by termination if the breach isn't cured.

See also the post-termination wrap-up provisions of [NONE].

### 22.139.26 Automatically-material Provider breaches

The following breaches by Provider are automatically deemed material:

a. Provider does not timely start to perform the services, if the parties have agreed in writing that a specific start time is material, AND Customer terminates the statement of work before Provider does start performance;

b. Provider is clearly shown to have permanently abandoned performance;

c. Provider is clearly shown to have temporarily suspended performance IF the Contract or the statement of work prohibits suspension; or

d. Provider does not timely complete the services, in compliance with the standards set forth in the Contract and/or the statement of work, IF the parties have agreed in writing that timeliness is material (for example, by stating that time is of the essence).

*Commentary*

It can be useful to designate certain breaches as automatically being deemed material, for reasons discussed in the commentary to [NONE].

### 22.139.27 Other remedies for breach

A party's right to terminate a statement of work for breach would be in addition to any other recourse available to that party under the Contract, the statement of work, or the law (subject to any agreed limitations of liability).

*Commentary*

This is a roadblock provision intended to forestall (or at least discourage) creative arguments to the contrary.

### 22.139.28 Termination of a statement of work at will

a. Customer may terminate any statement of work at will (synonym: for convenience), but only as stated in [NONE].

b. Provider may not terminate any statement of work at will

*Commentary*

Subdivision a — *alternative:* "Customer may not terminate a statement of work until the following prerequisites are satisfied: *[Describe in detail in the Contract]*."

Subdivision a — *alternative:* "Neither party may terminate a statement of work at will."

Termination *at will* of a statement of work can be a complicated proposition:

• For obvious reasons, service *providers* typically won't get the right to terminate at will (because few customers will want to allow a service provider to just walk away, possibly leaving the customer in the lurch for something important).

• Sometimes, a services *customer* will want the right to terminate a statement of work "at will" or "for convenience." For many situations, that might be entirely sensible — as long as a sudden termination wouldn't leave the provider holding the bag for unrecoverable costs (past and/or future).

For example

- Suppose that a services provider, upon agreeing to a statement of work, invested money to find, recruit, and train extra people to do the work.
- Or perhaps the services provide invested in extra equipment that would be needed.

In either of these cases, a sudden termination at will by the customer could leave the provider stuck with the salaries of the extra workers who would now be unable to earn revenue from the customer's job and might not have other billable work to do, and/or with the costs of the extra equipment.

Iin such a situation, the provider might want to bargain for:

1. an earliest permissible date for termination-at-will, so that the customer's payments would cover at least some of the provider's investment;

2. a minimum advance-notice period, for the same reason, and to give the provider time to find other work for the provider's people who were assigned to the customer's project; and/or

3. an early-termination fee that the customer must pay if the customer terminates at will before specified dates and/or milestones are reached.

### 22.139.29 Provider's post-termination obligations

Promptly after any termination of a statement of work, Provider is to cause the "*Termination Deliverables*," namely the following, to be delivered to Customer or to Customer's designee:

a. all completed deliverables and work-in-progress for that statement of work — those, however, will remain subject to any agreed restrictions on providing them to competitors of Provider;

b. any equipment that was provided or paid for by Customer for use in connection with that statement of work;

c. any Customer-owned data that was provided by or on behalf of Customer; and

d. any Customer-owned data that was generated by or on behalf of Provider, in connection with that statement of work; and

e. one or more final invoices for the statement of work.

*Commentary*

Like software, contracts (and statements of work) should come to an end gracefully and neatly, tying up loose ends to the extent practicable. This turnover requirement is fairly typical of what customers want to see.

**Pro tip:** Drafters representing customers should consider [PH].

### 22.139.30 Customer's payment of final amounts

Promptly after any termination of a statement of work, Customer is to pay, in accordance with the agreed payment terms:

a. all then-pending Provider invoices; and

b. Provider's subsequent final invoice(s) for previously unbilled services,

and/or (if applicable) reimbursable expenses,

to the extent consistent with any payment prerequisites in the statement of work,

for example, any requirement that particular milestones be achieved as a prerequisite for payment,

unless otherwise agreed in writing.

*Commentary*

The reality is that if a statement of work is terminated by *either* party, the customer might be tempted to withhold payment so as to maintain some leverage over the provider.

This turnover requirement is fairly typical of what customers want to see.

**Pro tip:** Drafters representing service providers should consider [PH].

### 22.139.31 Continued confidentiality obligations

Upon any termination of a statement of work, each party will continue to honor any applicable confidentiality obligations stated in the Contract and/or in the statement of work.

### 22.139.32 Premises- and computer-network rules apply

a. Tango Clause 22.144 - Site Visits will apply if either party's personnel visit physical premises of another party

b. Tango Clause 22.33 - Computer System Access will apply if either party's personnel access another party's computer system(s) and/or network(s).

### 22.139.33 No guaranteed minimum work

In case of doubt, the Contract does not entitle Provider to any minimum amount of work, nor to any minimum compensation.

*Commentary*

It's not unheard of for service providers (and their lawyers) to claim that they were somehow entitled to a certain minimum amount of billable work or of compensation.

• This was seen a Louisiana case in which Dow Chemical Co. terminated a contractor "at will" on 90 days' notice, as permitted by the contract, but then did not assign the contractor any work during the 90-day notice period. A jury awarded the contractor the lost profits it supposedly would have received if it had gotten work; the Fifth Circuit, however, held that the contract unambiguously did *not* require Dow to assign the contractor work during the termination-notice period.

See Gulf Eng'g Co. v. Dow Chem. Co., 961 F.3d 763, 766-67 (5th Cir. 2020) (reversing denial of partial summary judgment and rendering judgment in favor of Dow).

• In a Chicago case, a subcontractor claimed that its prime contractor, IBM, had breached an alleged promise to provide the subcontractor with $3.6 million of work on a project for the Chicago Transit Authority. IBM won the case on summary judgment, but again it still had to defend against the claim.

See Bus. Sys. Eng'g v. IBM, 547 F.3d 882 (7th Cir. 2008), *affirming* 520 F. Supp. 2d 1012 (N.D. Ill. 2007).

### 22.139.34 Option: Omission of Work is Permitted *[placeholder only]*

*This section does not yet include any rule text; it's included as a placeholder and checklist reminder.*

*Commentary*

Construction contracts often address whether the owner, or the prime contractor, can remove contracted work from a contractor or subcontractor and either reassign the work to another party or simply *do* the work. Authors from the White & Case law firm summarize:

> … in the absence of clear contractual wording to the contrary, employers will not be entitled to descope the entirety or a substantial proportion of a contractor's work.
>
> The rationale is that the descoping by an employer of all or a large part of the works deprives the contractor of the opportunity to make a profit on the omitted works; often the basis for the contractor's entering of the contract.
>
> Additionally, it may be considered a breach of the employer's duty of good faith to the contractor, particularly under contracts governed by civil law regimes.

Julian Bailey, Michael Turrini, and Mark Sanders, Descoping of works: what is the employer entitled to do? (WhiteCase.com 2017), archived at https://perma.cc/29BS-C9G6 (extra paragraphing added). See generally, e.g.: • Frederic Akiki and Julian Bailey, Descoping: Can the omission of works constitute a breach of contract? (JDSupra 2020); • (unnamed) Is it permissible under FIDIC Contracts to omit work from the Contractor and give it to another Contractor during the course of the project? (Derenco.com 2011)

### 22.139.35 Option: Provider's Assumption of Investigation Risk

a. If this Option is agreed to, it applies whenever Provider agrees to a statement of work.

b. By agreeing to the statement of work, Provider warrants to Customer that Provider has investigated the conditions "on the ground" (a figure of speech), in connection with which the services are to be

provided, as of the time that Provider agreed to the statement of work.

c. Provider will not be entitled (i) to an adjustment in compensation, nor (ii) to an extension of time for performance, if in hindsight those conditions on the ground prove to have been other than as Provider thought, because the parties have bargained for Provider to assume the risk on that score.

d. To reduce the chances of inadvertent overpayment by Customer, Provider is not to invoice Customer for additional compensation in violation of subdivision c without Customer's prior, unambiguous, written approval of the specific additional compensation sought. Any such invoicing by Provider would be a material breach of the Contract.

*Commentary*

Both service providers and customers should consider specifying who is responsible for making sure that the relevant portion of "the real world" is what the parties think it is, and expressly allocating that responsibility in the contract.

Here's an example of how not verifying conditions on the ground can go south for a service provider, involving the construction of a new apartment complex in Corpus Christi, Texas: • A general contractor solicited a bid from an excavation company for site grading and excavation work. The general contractor sent documents to the excavation company, including proposed contract terms, a topographical survey of the site, and the planned final elevations. • The subcontract between the excavation company and the general contractor included the following provision:

> Execution of this Agreement by the Subcontractor is a representation that **the Subcontractor has visited the Project site**, become familiar with local conditions under which the Work is to be performed and correlated personal observations with requirements of the Contract Documents.
>
> **The Subcontractor shall evaluate and satisfy itself** as to the conditions and limitations under which the Work is to be performed, including without limitation: (1) the location, condition, layout, and nature of the Project site and surrounding areas; (2) generally prevailing climactic conditions; (3) anticipated labor supply and costs; (4) availability and cost of materials, tools, and equipment; and (5) other similar issues.
>
> Accordingly, **Subcontractor shall not be entitled** to an adjustment in the Contract Price or an extension of time resulting from Subcontractor's failure to fully comply with this paragraph.

D2 Excavating, Inc. v. Thompson Thrift Constr., Inc., 973 F.3d 430, 432 (5th Cir 2020) (emphasis and extra paragraphing added).

• But the excavation company did *not* visit the project site as represented in the above contract clause. (Instead, the excavation company used computer software and the general contractor's topographical survey to estimate how much dirt would need to be removed.) As it turned out, more dirt needed to be removed than either party had anticipated — in part because of the general contractor's mismanagement of other subcontractors' work. *See id.*, slip op. at 3-4.

• The excavating company and the general contractor apparently agreed *orally* that the general contractor would pay for the extra dirt removal; the general contractor told the excavating company that the general contractor "would issue a written change order for the additional work once it was finished so that it would be easier to calculate what it owed," but that never happened — and the general contractor never did pay for the extra dirt removal. Cf. [NONE] and [NONE], which allow *oral* changes to statements of work but such changes must be proved by clear and convincing evidence.

The excavating company sued the general contractor for the cost of the extra dirt removal. After a bench trial, the district court awarded damages to the excavation company for that additional work. The excavating company also sued the company that had issued the general contractor's payment bond. See 933 F.3d at 433 n.2; see also the discussion of payment bonds at Section 22.119.1.2: .

The Fifth Circuit vacated that part of the district court's judgment, holding that the excavation company was *not* entitled to be paid for the additional dirt removal, because *the excavation company had assumed the risk* that conditions at the site were not what it anticipated.

## 22.139.36 Option: Mitigation of Schedule Slips

a. If this Option is agreed to, it applies if a statement of work clearly states that a particular milestone:

1. is material, and
2. must be completed by a specified date.

b. If that milestone is not completed by the specified date,

then Provider will make efforts that are reasonable under the circumstances

to mitigate any harm resulting from the delay

and to get the statement of work back on schedule.

*Commentary*

In some fields (e.g., software development), it's pretty difficult for a service provider to accurately estimate how long a project will take — and that, in turn, means that schedule slips are not uncommon. In fact, there's an old joke in the software world, attributed to Tom Cargill of Bell Labs, that "The first 90 percent of the code accounts for the first 90 percent of the development time. The remaining 10 percent of the code accounts for the other 90 percent of the development time." It's never a bad idea for contract drafters to try to plan around this reality.

See Ninety-ninety rule (Wikipedia.com).

## 22.139.37 Option: Prohibited Use of Deliverables by Others

If this Option is agreed to, Customer may not allow others (for example, Customer's other contractors) to use deliverables provided by or on behalf of Provider under the Contract,

not even if such use by others is for Customer's own business purposes.

*Commentary*

In one type of services project, the service provider is a software developer that creates a custom version of its software package for a particular customer and retains the ownership rights in the custom version. In that situation, the software developer might well want to preclude the customer from allowing third parties to use the software, for economic reasons and/or to preserve the developer's trade-secret rights in the software.

### 22.139.38 Option: Customer Ownership of IP Rights

If this Option is agreed to, then the following terms apply:

a. As between Provider and Customer,

Customer, not Provider, will own the intellectual-property rights (if any) in and to any deliverables,

that are created in the performance of Provider's obligations under a statement of work,

by one or more employees of Provider (and/or of Provider's subcontractors, if any).

b. Provider is to seasonably (see the definition in Clause 22.156) disclose to Customer,

in writing, and in as much detail as Customer reasonably requests,

all technology and other intellectual property to be owned by Customer under the statement of work.

c. Tango Clause 22.86 - Intellectual Property Ownership will govern the administrative details of establishing, confirming, and/or registering Customer's ownership claim(s) under this Option.

*Commentary*

This Option might be relevant if a customer hires a provider to create a deliverable, and the customer wants to own the intellectual-property rights in the deliverable. *Example:* The customer might engage a software developer to design and build a new software package that the customer wants to use in its business, and the customer wants to own the copyright and other IP rights in the new software.

But this Option reverses the usual rule that, with limited exceptions, an author or inventor owns the intellectual-property rights in his- or her creations, and likewise a service provider, not the provider's customers, will own the work product of the provider's employees.

Normally, when a service provider creates copyrighted works or other intellectual property in the course of its work — for example, a Website or a software package — the provider will typically want to own the the intellectual-property rights; in large part, so that the provider can reuse its work for future customers. This normal practice is often economically desirable:

- *Current* Customer D gets the benefit of the provider's work for *past* Customers A, B, and C — which lowers the provider's internal costs for doing its work for current Customer D, which in turn enables the provider to offer a lower price to Customer D;
- In return, Customer D "pays it forward" by accepting that the provider will own its work product and thus will later have the right to reuse the work product (except for Customer D's confidential information) for *future* Customers E, F, G, etc.

Subdivision a: This Option refers to ownership "[a]s between Provider and Customer"; this wording takes into account that third parties might have ownership claims, which Provider isn't warranting against unless otherwise agreed.

Subdivision b puts an affirmative obligation on Provider to turn over to Customer the things that Customer is to own; otherwise, Customer might never know that it was entitled to ownership of specific work product.

### 22.139.39 Option: Loss of Rights for Nonpayment

a. If this Option is agreed to, Customer's timely payment of any amounts required by the applicable statement of work,

in respect of a particular deliverable,

is a prerequisite to Customer's continued exercise of its rights in that deliverable.

b. Customer's nonpayment, however, will not be deemed to cause Customer's use of the deliverable to infringe Provider's intellectual-property rights,

until Customer's time for curing the nonpayment has ended.

*Commentary*

**Caution:** Technically, this Option could turn a late-paying customer into an infringer of the provider's intellectual-property rights, as discussed in the commentary at § 22.120.7.

### 22.139.40 Option: Post-Termination Deliveries Delay

IF: This Option is agreed to; AND Provider's already-sent invoices,

for any statement of work,

are past due when any statement of work is terminated,

THEN: Provider may delay delivery of one or more Termination Deliverables,

for any statement of work

until all of Provider's past-due invoices are paid in full.

*Commentary*

The purpose of this Option should be pretty obvious. (Its mirror image is in [NONE].)

### 22.139.41 Option: Customer Post-Termination Payment Delay

IF: This Option is agreed to; THEN: Upon termination of a statement of work,

Customer need not pay Provider's final invoice(s) for then-unbilled services, if any,

until Provider has complied with its applicable post-termination obligations

for that statement of work.

*Commentary*

The purpose of this Option should be pretty obvious. (Its mirror image is in [NONE].)

### 22.139.42 Option: Adjustment of Final Payment for Material Breach

IF: This Option is agreed to; AND: A statement of work is terminated for material breach (see the definition in Clause 22.102.2) by Provider;

THEN: Customer's final payment obligation is to be adjusted appropriately,

preferably as agreed by the parties,

but if not, as determined by a tribunal of competent jurisdiction in accordance with [PH].

*Commentary*

This is a dispute-management provision, intended to strongly nudge the parties in the direction of early settlement.

### 22.139.43 Option: Expiration as Termination

If this Option is agreed to, expiration of a statement of work is to be considered a form of termination.

*Commentary*

Including this Option could trigger various post-termination obligations.

### 22.139.44 Reading review: Services

1. List *one* point from this reading that you're glad you knew *before* doing the reading about chapter 4 (services) — or that you're glad you learned *from* doing it.

2. List *three* points in this reading that you would want *MathWhiz* to be sure to know if you were representing that company.

3. Same as #2, but this time as if you were representing *Gigunda*.

### 22.139.45 Service: Discussion questions

1. How much time should a lawyer spend reviewing the statement of work for a client?

2. Should Provider agree to obtain *all* permits and licenses needed *related to* the performance of services? (Careful: Think broadly about what permits and/or licenses might be needed "related to" the services.)

3. What could happen if Provider failed to get required occupational licenses, e.g., construction-contractor licenses?

4. FACTS: A home builder finishes a new house and turns the keys over to a young couple, who move in with their new baby (and the wife's in-laws, visiting from out of town). BUT: The builder failed to get the final city inspection done, so the city orders the family to move out, and they have to spend three days in a hotel. QUESTION: Who pays the hotel bills?

5. Why would a customer/client want to require a contractor to use people who are "competent and suitably trained for the task"? (Think: Litigation proof.)

6. What does "workmanlike performance" mean? Why is that typically used as a standard of performance for services?

7. Why might a customer want to state that the service provider is responsible for determining the "means and manner" of the work?

8. What are "the Three Rs" for defects in deliverables?

## Clause 22.140 Settlement Rejection Consequences

### 22.140.1 Applicability

This Clause will apply, in the interest of promoting the settlement of disputes, in any dispute arising out of or relating to the Contract or any transaction or relationship resulting from the Contract.

*Commentary*

An experienced in-house lawyer points out that lawyers are often overly-optimistic about their prospects, which can hurt their clients' prospects in a dispute:

> One study found that when plaintiffs rejected a settlement in favor of going to trial, they fared worse than the settlement offer 61 percent of the time. When plaintiffs were wrong, it cost an average of US$43,000. In other words, the settlement offer the plaintiff rejected was, on average, US$43,000 more than the amount awarded at trial. Defendants, while faring worse at trial than the rejected offer only 24 percent of the time, paid more dearly for being wrong — US$1.1 million on average. * * *
>
> … Lawyers may be particularly susceptible to optimism bias because of their ethical duty to zealously advocate for their clients, causing them to more readily adopt narratives that support their client’s best arguments and theories, poten-

> tially blinding them to other, possibly more important, believable, or persuasive narratives.

Brian W. Jones, With the Advancement of Predictive Analytics, Consider Using FRCP 68 During Litigation, ACC *[Association of Corporate Counsel]* Docket, Oct. 2020, at 56, 60, 61 (ACCDigitalDocket.com) (footnotes omitted).

### 22.140.2 Definition: Covered Settlement Offer

The term "*Covered Settlement Offer*" refers to a written offer that:

1. expressly states that it (the offer) is subject to this Clause; and
2. makes a proposal to settle a dispute.

*Commentary*

Subdivision 1: The "expressly states" requirement is intended to prevent a party from being ambushed by another party's claim that (for example) a vague settlement proposal from the other party constituted a Covered Settlement Offer.

### 22.140.3 Expense-shifting

If a party rejects a Covered Settlement Offer,

> but then fails to obtain a final result in the dispute that is at least 20% more favorable than the Covered Settlement Offer,
>
> then the rejecting party must pay or reimburse the offeror's attorney fees (see the definition in Clause 22.16) that the offeror incurred in the dispute after making the Covered Settlement Offer.

*Commentary*

This Clause is modeled roughly on the offer-of-judgment provisions in Rule 68 of the Federal Rules of Civil Procedure. Unfortunately, Rule 68 is largely toothless, because it only shifts subsequently-incurred court costs, which usually don't amount to a lot of money in the scheme of things; moreover, Rule 68 doesn't shift the burden of attorney fees, which can be huge. As a result, most litigators don't regard Rule 68 as providing much of an incentive to settle.

> See, e.g., Lewis E. Hassett, "Pretty Soon You're Talking Real Money" — Federal Court Shifts Cost of E-Discovery (MMMLaw.com 2010), archived at https://perma.cc/2QRQ-7EXR.

A somewhat-better approach is New Jersey Court Rule 4:58, which shifts not just court costs but also attorney fees. (The New Jersey rule, however, applies only

when exclusively-monetary relief is sought; the provision above doesn't contain such a restriction.)

Some empirical research by two law professors, of Northwestern University and (now) the University of Pennsylvania respectively, suggests that the New Jersey rule seems to encourage early settlement and to reduce attorneys' fee expenses, without affecting the size of the damage award for cases that do go to trial.

> See Albert Yoon and Tom Baker, Offer-of-Judgment Rules and Civil Litigation: An Empirical Study of Automobile Insurance Litigation in the East, 59 Vanderbilt L. Rev. 155 (2006).

Georgia and Florida have fee-shifting statutes similar to New Jersey's, as does Texas.

> See Ga. Code Ann. § 9-11-68; Fla. Stat. § 768.79; Tex. Civ. Prac. & Rem. Code ch. 42. In 2011, the Texas Legislature tightened the limits on the amount of fees and expenses that could be recovered, which is now capped at the amount of the jury verdict, as explained in this article.

A related concept is implemented in Arizona's compulsory-arbitration program for small-dollar disputes: In any civil case where the amount in controversy is less than an amount set by court rule (not more than $65,000), the court is normally required to send the case to arbitration. Relevant here: A party that 'loses' the arbitration can still demand a trial de novo in court. If the result of the trial de novo, however, is not at least 23% (??) better than the arbitration award, then the party demanding the trial must pay (i) the arbitrators' fee, and (ii) the other side's costs and attorney fees and expenses for the trial de novo.

> See Arizona Rev. Stat. 12-133. The Arizona compulsory arbitration statute has come under criticism; a pilot program giving parties an alternative option for a shortened courtroom trial, known as FASTAR, is in progress at this writing. See Christian Fernandez, Arizona's Compulsory Arbitration Program: Is It Time for a Reform? (2019).

### 22.140.4 Federal Rule 68 procedure

Matters of timing and other procedural issues concerning the Covered Settlement offer are to be governed in the general manner provided for an offer of judgment under Rule 68 of the [U.S.] Federal Rules of Civil Procedure (with any necessary change being made) to the extent the parties do not agree otherwise in writing.

*Commentary*

The general procedures of Federal Rule 68 are adopted here because: • they cover the required ground reasonably well, and • they're familiar to (U.S.) counsel.

*Example:* In 2018, singer-songwriter Tracy Chapman ("Fast Car") sued hip-hop star Nicki Minaj, alleging that Minaj's song "Sorry" infringed the copyright in Chapman's song "Baby Can I Hold You." Eventually Minaj made an offer of judgment under

Rule 68, proposing to settle the case by paying Chapman $450,000; Chapman accepted the offer.

Anastasia Tsioulcas, Tracy Chapman Wins Lawsuit Against Nicki Minaj (NPR.org Jan. 8, 2021).

### 22.140.5 Confidentiality of settlement discussions

Absent consent of the other party, each party shall preserve in strict confidence:

1. the existence and details of any Covered Settlement Offer made by the other party; and

2. any communications between the parties regarding any Covered Settlement Offer.

*Commentary*

Confidentiality of settlement offers would normally be required by standard American rules such as Rule 408 of the Federal Rules of Evidence; this subdivision makes that requirement explicit.

## Clause 22.141 Settlement-Discussion Confidentiality

a. The parties' communications made in the course of any escalation, neutral evaluation, or other settlement-related discussions under this Clause,

as well as the results of any evaluation by a neutral under Tango Clause 22.108 - Neutral Evaluation (Non-Binding),

are to be treated as having been made in compromise negotiations, with the effect stated in Rule 408 of the [U.S.] Federal Rules of Evidence.

b. In case of doubt, subdivision a will apply regardless whether Rule 408 would apply in a court proceeding or arbitration.

## Clause 22.142 Shall Definition

Unless the context clearly and unmistakably requires otherwise, terms such as "Party A shall take Action X" mean that Party A is required to take Action X; likewise, terms such as "Party B shall not take Action Z" means that Party B is prohibited from taking Action Z.

*Commentary*

A plain-language drafting guide published by a coalition of (U.S.) federal employees says: "Besides being outdated, 'shall' is imprecise. It can indicate either an obligation or a prediction."

> Federal Plain Language Guidelines at 25 (PlainLanguage.gov 2011) (emphasis added).

The same is true in some other English-speaking countries, where the term *shall* might be construed as tentative or optional, not as mandatory.

> See, e.g., a New Zealand legislative drafting guide at A3.33 and an Australian legislative-drafting guide, at page 20.

Even in the United States, *shall* might not be mandatory; the U.S. Supreme Court had an intramural dispute on that point, in the context of a particular federal statute.

> See Gutierrez de Martinez v. Lamagno 515 U.S. 417, 433 n.9 & accompanying text (1995); *id.* at 439 & n.1 (Souter, J., dissenting). (*Author's note:* From a strictly lexical perspective, it seems to me that Justice Souter's dissent had the better of the argument.)

And here's another illustration of the Court's non-mandatory use of *shall*: "As we shall discuss in more detail, …. As we shall explain, …. "At this stage, we shall do the same." *Id.* at 2520.

> Florida v. Georgia, 585 U.S. __, 138 S. Ct. 2502, 2511, 2520 (2018) (Breyer, J.).

On the other hand, the D.C. Circuit has held that *shall* was mandatory in a contract's forum-selection clause saying that a Saudi grievance council "shall be assigned for settlement of any disputes or claims arising from" the contract. The contrary argument wasn't frivolous — the court said: "To be sure, one way to make a clause mandatory is to specifically refer to the designated forum as 'exclusive' of other fora."

> D&S Consulting, Inc. v. Kingdom of Saudi Arabia, 961 F.3d 1209, 1213-14 (D.C. Cir. 2020) (affirming dismissal; citations omitted).

For many terms, the author prefers *will* or *is to*, not *shall*, for contract obligations for business reasons:

- The term *will* seems to have a more-collaborative feel to it, and less of a master/servant tone, than *shall*. That can provide just a smidgen of help in establishing a cooperative attitude among the parties, which can be important to a successful long-term relationship or even to just a one-shot transaction.
- From a sales-psychology perspective, in a contract drafted by a supplier, the term *will* seems softer and more deferential; it pays the customer the respect of implicitly acknowledging that the customer can walk away before signature.

## Clause 22.143 Signatures

### 22.143.1 Signing separate copies

If a document is to be signed by more than one party, then the parties may sign and exchange separate physical copies (also known as "counterparts"); each such copy is considered part of the same legal instrument.

*Commentary*

It's common for each party to want its own, fully-signed "original" of a contract; the above language provides for that.

If hard copies are going to be manually signed, see Section 3.7: for suggestions on how to draft the signature blocks to avoid possible challenges later.

### 22.143.2 Exchanging signed signature pages only

A party may deliver a signed document to another party by transmitting just an original, or a copy, of a signed signature page.

*Commentary*

Nowadays it's quite common for the parties, in different locations, to sign separate copies of a contract and for each party to email the other party a PDF of its signed

signature page only; the above language supports this practice.

**Caution:** If only the signed signature pages of a contract will be exchanged, the parties should make sure it's clear that everyone is signing the same version of the document, otherwise the contract might not be binding, as recounted at [BROKEN LINK: sigs-mech-cmt][BROKEN LINK: sigs-mech-cmt][BROKEN LINK: sigs-mech-cmt].

### 22.143.3 Electronic signatures

The parties may sign the Contract electronically, including but not limited to by exchanging emails and/or text messages.

*Commentary*

Electronic signatures are explicitly authorized in U.S. law and are increasingly popular in business, as discussed in detail at Section 3.9.1: . The above language makes it clear that the parties *agree* to electronic signatures — doing so "checks a box" in section 5(b) of the Uniform Electronic Transactions Act; see, e.g., Tex. Bus. & Comm. Code § 322.005(b), which states:

> (b) This title applies only to a transaction between parties each of which has agreed to conduct the transaction by electronic means. Whether the parties agree to conduct a transaction by electronic means is determined from the context and surrounding circumstances, including the parties' conduct.

**Caution:** California's version of the UETA places some restrictions on what can constitute the parties' agreement to conduct a transaction by electronic means.

> See Cal. Civ. Code § 1633.5(b) (emphasis and extra paragraphing added).

Under California law, a car dealer apparently must still obtain a *manual* contract signature from a car buyer.

> See Cal. Civ. Code § 1633.3(c) (various carve-outs from authorization of electronic signatures) and Cal. Veh. Code § 11736(a) (requiring signed agreement with car-buying consumer).

## Clause 22.144 Site Visits

### 22.144.1 Introduction; parties

a. This Clause applies if and when one or more individuals under the control of a party is to access a "*Site*" of another party (the "*Host*"), namely:

1. any physical premises of the Host; and/or
2. any computer system or network of the Host.

b. Each such individual is referred to as a "*Visitor*";

the party controlling the Visitor is referred to as the "*Accessing Party*";

the Accessing Party might be the Visitor him- or herself, or it might be the Visitor's employer or other controlling person.

c. Any such access is referred to as a "*Site Visit*" — which could take the form of (without limitation):

1. a Visitor's in-person presence at the Host's physical premises; and/or
2. a Visitor's access to a computer system or network of the Host — in which case Tango Clause 22.33 - Computer System Access will also govern.

*Commentary*

Customers' contract forms for providers of goods and services often include provisions along the lines of this Clause.

In many services-type agreements, the "Host" will be the customer, while the "Accessing Party" will be the services provider coming onto the customer's site or accessing the customer's computer network. (The same could be true of providers of goods if the provider's personnel will be, e.g., making deliveries at the customer's site, or if sales people will be making in-person calls at the customer's premises.)

On the other hand, in other types of agreement, it might be the other way around, e.g., with a customer's people coming onto a service provider's site for training, to have work done on vehicles or equipment, etc.

Some drafters might want to make this Clause a one-way provision so that only one party is a Host and the other an Accessing Party.

### 22.144.2 Site rules for Visitors

At all times during a Site Visit, each Visitor must comply with:

1. this Clause;

2. Tango Clause 22.33 - Computer System Access, where applicable; and

3. such other reasonable Site rules and policies

as the Host timely (see the definition in Clause 22.156) communicates

to the Visitor and/or to the Accessing Party.

### 22.144.3 Host personnel conduct

a. At all times during a Site Visit, the Host must cause all personnel subject to the Host's control (as limited by subdivision b) to refrain from "unlawful conduct" (defined in subdivision c).

b. For purposes of subdivision a, Visitor personnel are not considered to be subject to the Host's control.

c. For purposes of subdivision a, "unlawful conduct" refers to any and all of the following:

1. denying access to the Site to a Visitor for any reason prohibited by applicable law;

2. otherwise discriminating against a Visitor for any reason prohibited by applicable law; and/or

3. other unlawful conduct against the Visitor — which includes, without limitation,

tortious conduct, and/or

conduct prohibited by anti-harassment or anti-retaliation law.

### 22.144.4 Evidence of Visitor employability

IF: The Host timely asks the Accessing Party in writing;

THEN: The Accessing Party must provide the Host with reasonable evidence that the Accessing Party's Visitors who will access any physical premises of the Host are legally employable where those premises are located.

*Commentary*

A given company might feel compelled to verify employability of any individual that comes on its premises. (That's especially possible if a company had previously entered into a non-prosecution agreement after being caught employing aliens not having the legal right to work.)

This provision shouldn't be too contentious, given that U.S. law already requires most if not all employers to verify that their employees have the right to work in this country.

### 22.144.5 Mutual non-interference efforts

a. Visitors and Host personnel are to make reasonable efforts to avoid interfering with each other at any site where both are present.

b. The Host and the Accessing Party are to instruct their respective personnel to comply with subdivision a.

*Commentary*

Some customers might want this to be a one-way clause, where it's only the on-site service provider that must make an effort to avoid interference with the customer, and not vice versa.

## Clause 22.145 Software Licenses

Contents:

### 22.145.1 Applicability; parties

This Clause applies when, under the the Contract, a party ("*Licensor*") is to grant a license,

or when Licensor grants a license in the Contract itself,

to another party ("*Customer*") concerning specified "*Software*."

*Commentary*

Language choice: Given that this Clause uses the term *Licensor* as the defined term for the license-granting party, it uses *Customer*, instead of *Licensee*, for the license recipient; the visual difference in the two forms should make things easier on readers.

### 22.145.2 *Written* license grant required

a. A "*Software License*" must be granted by a written document, which is referred to for convenience as a "*License Granting Document*."

b. The Contract may itself be the License Granting Document.

c. In some circumstances, the Software License might be granted via a reseller or other intermediary, as opposed to being granted directly by Licensor.

*Commentary*

Subdivision c addresses an "edge case" that seems unlikely to come up very often.

### 22.145.3 Possible forms of License Granting Document

a. A License Granting Document might take the form of, for example:

1. a purchase order agreed to by (or on behalf of) Licensor;

2. a quotation agreed to by (or on behalf of) Customer;

3. and/or an on-line sign-up form for downloading a copy of the Software and/or for gaining access to an online version of the Software,

for example in the case of so-called software as a service (known in the industry as "SaaS").

b. The License Granting Document might refer to provisions in one or more external usage plans, service plans, maintenance plans, or similar external documents,

in which case those referenced provisions are deemed part of the License Granting Document (i.e., incorporated by reference) as indicated.

c. The Contract may specify that the License Granting Document is an Order for purposes of [PH].

*Commentary*

This section reflects the way business is typically done in the software world. (Source: Long personal experience.)

### 22.145.4 Delivery of Software

Licensor will cause the following to be delivered to Customer promptly upon the parties' agreement to the License Granting Document, if and to the extent not already done:

1. the Software;
2. the user documentation for the Software, if any; and
3. any required license codes for the Software.

*Commentary*

Certainly for enterprise-class software that's "on-prem" — that is, installed at Customer's premises, as opposed to software-as-a-service ("SaaS") where Customer accesses the Software over the Internet — chances are that Customer has been using the Software already on a trial-license basis; if that's the case, then the only thing Licensor might need to deliver would be license codes for the Software License (as opposed to license codes for the trial license).

### 22.145.5 Price of Software License

Customer need not pay anything for the Software License except as clearly stated in the applicable License Granting Document.

*Commentary*

This is a roadblock clause that some Customers might want for comfort.

### 22.145.6 Acceptance testing

Once Customer has agreed to the License Granting Document, Customer is deemed to have completed all acceptance testing of the Software that Customer wants to do, *unless* the License Granting Document clearly says otherwise.

*Commentary*

Acceptance testing is a revenue-recognition issue for publicly-traded software companies, many of which offer customers a significant pre-license trial period and therefore assume that customers will not buy a license until satisfied with the testing.

### 22.145.7 Permitted Customer use of Software

a. Under the Software License, Customer has only a limited, non-exclusive right to use the executable version of the Software, only during a particular time period specified in the License Granting Document (the "*License Term*"),

> although that time period might be perpetual if so stated in the License Granting Document or in the Contract;
>
> that right is subject at all times to the terms and conditions of the License Granting Document and the Contract.

b. The License Granting Document might include limitations on the number of users, servers, and the like, for which use of the Software is authorized by the Software License.

c. The License Granting Document might also include limitations on replacing one user, server, etc., with another.

*Commentary*

Here's an example of a real-life license limitation provision that the author once did for a client, adapted to use the above terminology:

> 3.x Customer may not use the Software in connection with more, in the aggregate, than the number of distinct corresponding "license units" (for example, workstations, servers, users, etc.) for which Customer is licensed as set forth in the applicable License Granting Document, except as otherwise provided in the Contract.
>
> HYPOTHETICAL EXAMPLE: Suppose that Customer is licensed to use the Software for 1,000 users. That means Customer may use the Software for an aggregate of 1,000 individual users in total; it does NOT mean that Customer may use it for an unlimited of total users as long as only 1,000 users are using the Software at any given time.
>
> 3.y If Customer permanently replaces one license unit with another one and deletes any and all data maintained by the Software and in respect of that license unit, then Customer may use the Software in connection with the replacement license unit in lieu of the replaced one.
>
> HYPOTHETICAL EXAMPLE: Suppose that Customer is licensed to use the Software, and in fact Customer does use the Service, for 1,000 users. Suppose also that ten of those users leave Customer's company, and that Customer completely deletes all data maintained by the Service for those ten users. In that case, Customer may use the Software for an additional ten users (bringing Customer's total users back up to 1,000) without paying additional license fees.

### 22.145.8 Effect of nonpayment

a. Customer's right to use the Software under the Software License is expressly conditioned on Customer's payment of any fees or other charges set forth (or referenced) in the License Granting Document.

b. IF: Customer does not timely pay such fees or other charges; THEN: Licensor has the option of revoking the Software License, after any grace period stated in the License Granting Document or otherwise in the Contract.

*Commentary*

A software customer might want to negotiate to include a provision such as [NONE] so that continued use of software after nonpayment of fees would not constitute copyright infringement — because *that* could lead to an award of serious damages, such as the customer's profits arising "indirectly" from the infringement, as discussed in the commentary there.

### 22.145.9 Use of Software for disaster recovery

From time to time during the License Term, Customer may make use of the Software for reasonable disaster-recovery testing and disaster-recovery operations,

> even if such use technically exceeds the use authorized by the License Granting Document,
>
> as long as such excess use does not amount to regular business use.

*Commentary*

This section likely would apply only to "on-prem" software, i.e., software that is installed and run on Customer's computer's as opposed to be hosted by Licensor and accessed by Customer over the Internet.

### 22.145.10 No service-bureau use

Customer may not use the Software in providing services to third parties, where functions performed by the Software are a material part of those services, *unless* the License Granting Document clearly says otherwise.

*Commentary*

Here's an analogy: Suppose that the SuperShuttle company, which provides airport shuttle service in many cities, goes to U-Haul and rents a trailer. A SuperShuttle representative signs U-Haul's standard rental agreement; that agreement says in part (hypothetically) that a renter may not use a rented trailer to carry cargo for third parties, nor allow others to do so, unless U-Haul gives its prior written approval.

(Why might U-Haul require prior written approval? Because if a renter were to make such broader use of a U-Haul trailer, or allow such use by others, it could usurp other potential customer opportunities for U-Haul; moreover, U-Haul might be incurring additional risk by having its trailers exposed to a broader range of potential plaintiffs.)

Now suppose that a SuperShuttle worker drives a shuttle bus to the U Haul lot to pick up the rented trailer. A U-Haul sales agent hitches the trailer to the shuttle bus and shows the SuperShuttle worker how to hitch and unhitch it. The SuperShuttle worker drives the shuttle bus and trailer back to the airport — and SuperShuttle starts using the shuttle bus-trailer combination to pick up and deliver luggage and other cargo as part of its passenger-shuttle service. That would be a breach of the (hypothetical) rental agreement with U-Haul.

### 22.145.11 Customer is responsible for computer hardware, etc.

As between Customer and Licensor, *Customer* is exclusively responsible for the supervision, management and control of Customer's use of the Software,

> and for the provision and proper maintenance of Customer's hardware and supporting software,
>
> such as, for example, operating-system updates and virus-protection software,
>
> unless the License Granting Document clearly says otherwise.

*Commentary*

This section might need to be overridden in the Contract if Licensor is a "total package" service provider that functions as an outsourced IT department for Customer, perhaps providing desktop- and laptop computers, taking care of software updates, etc.

### 22.145.12 No bypassing of usage-control mechanisms

Customer may not attempt (successfully or otherwise) to disable or work around any usage-control mechanism that may be built into the Software,

nor permit or assist others to do so or attempt to do so.

*Commentary*

Some customers (very few, usually) just can't seem to resist the temptation to try to use licensed software for more than they pay for, e.g., for more users, more servers, etc. That's roughly the equivalent of buying one ticket to see a movie, entering the theater, and then letting your friends in through a side door.

Software licensors often build in usage-control mechanisms, but there are often ways for cheaters to work around those mechanisms — even though doing so usually constitutes copyright infringement, which can carry stiff penalties, as discussed in the commentary to [NONE].

### 22.145.13 No reverse engineering, etc.

a. Customer may not decompile, disassemble, or reverse engineer any part of the Software,

nor permit or assist others to do so.

b. If applicable law permits Customer to engage in such activity notwithstanding the Contract,

then Customer will provide Licensor with advance notice and reasonably detailed information concerning Customer's intended activities.

*Commentary*

Unfortunately, it's not unheard of for a customer to allow a licensor's competitor to "reverse engineer" the licensor's software to see what makes it tick and copy its functionality. Reverse engineering can take the form, generally, of one or more of:

- using a "disassembler" or other tool to obtain the source code of the software; and/or
- operating the software and observing its behavior, then using that information to try to figure out what's going on inside.

See generally Reverse engineering and Black box (each, Wikipedia.com).

Courts will enforce contractual prohibitions against reverse engineering, as discussed in the commentary at Section 22.34.10.2: .

### 22.145.14 No sublicense or transfer of Software

Customer may not rent, lease, sell, or sublicense any part of the Software, *except* to the extent — if any — permitted by (i) the License Granting Document, or (ii) the applicable agreed usage plan, if any.

*Commentary*

Licensor drafters will want to make sure that this section doesn't conflict with any authorization for Customer to assign the Contract; see Tango Clause 22.10 - Assignment - Assignee Assumption and Tango Clause 22.11 - Assignment Consent.

### 22.145.15 No increase in usage limit from new version

a. If Customer is provided with a new or different version of an item of Software ("*New Version,*" for example as an update or upgrade), that fact will not in itself increase the number of license units for which Customer is licensed, *even if* (for example) the New Version has a different license-installation code than a previous version provided to Customer.

b. Customer may not use both the New Version and another version if such use would exceed the use permitted by the License Granting Document.

c. In case of doubt: Customer is not entitled to be provided with any New Version of an item of Software *unless* the License Granting Document or the Contract clearly say otherwise.

*Commentary*

This should be pretty much self-explantory.

### 22.145.16 Customer will not acquire *ownership* of the Software

a. In case of doubt, the Software is licensed, not sold.

b. Licensor and/or its supplier(s), as applicable, retain title and all ownership rights, of whatever nature,

to the Software,

and to any tangible copy or copies of the Software provided to Customer.

c. Customer has no rights in the Software other than those expressly granted by the License Granting Document.

*Commentary*

Cross reference: Tango Clause 22.139.38 - Option: Customer Ownership of IP Rights.

### 22.145.17 No providing of Software copies to others

a. The Software (and its documentation, if any) remain the confidential property of Licensor or its suppliers, as applicable.

b. Customer may not provide copies of the Software to others,

nor may Customer disclose any license keys or license codes needed to operate the Software to others,

except as clearly permitted by the License Granting Document or by the Contract,

or with Licensor's express prior written consent.

### 22.145.18 Backup copies of Software

Customer may make a reasonable number of copies of the Software and, if applicable, its documentation, for backup purposes.

*Commentary*

Some outdated license agreements — probably unchanged since the era of floppy disks — say that the customer may make *one* backup copy; in this day and age that's impracticable because it's not how modern backup systems work.

### 22.145.19 Licensor audit of Customer's Software usage

a. Licensor may make reasonable requests that Customer report the actual details of usage of the Software under the Software License,

to help confirm that Customer is in fact complying with the license-unit restrictions of the License Granting Document and the

Contract.

b. If Licensor so requests, Customer will:

1. run one or more software reporting utilities, and

2. provide Licensor with electronic and/or hard copies of any output of such reporting utilities.

c. Licensor will give Customer at least ten business days to respond to any such request for a Customer usage report.

d. Customer will timely comply with any such Licensor request.

e. Licensor may audit Customer's usage reports, upon reasonable notice to Customer, in accordance with [PH].

f. Licensor will not disclose or use information in Customer's usage reports *except* to help ensure Customer's compliance with the Contract *and/or* as otherwise permitted by the Contract and/or by Licensor's written privacy policy.

*Commentary*

Usage-audit provisions are seen mainly in licenses for "on-prem" software that is installed at the customer's own premises — if the licensor itself is hosting the software (or using an outsourcing service such as Amazon's AWS), the licensor can do its auditing.

### 22.145.20 Support for outdated versions

Licensor need not support outdated versions of the Software unless unambiguously so stated in the License Granting Document.

*Commentary*

It can be expensive for a software provider to offer continued support for outdated software versions — moreover, as time goes on, eventually the provider might not have anyone who actually knows the outdated versions well enough to do the needful.

### 22.145.21 Customer representation of legal compliance

Customer represents (see the definition in Clause 22.134) that, so far as Customer knows (see the definition in Clause 22.90), applicable law does not prohibit Customer from using the Software.

*Commentary*

It's possible that a customer could be on some sort of government list of prohibited recipients of software under applicable export-control law; see the commentary at Section 14: .

### 22.145.22 U.S. Government customers: The Software is "commercial"

a. The Software and its accompanying documentation are "commercial computer software" and "commercial computer software documentation," respectively, pursuant to DFAR Section 227.7202 and FAR Section 12.212, as applicable.

b. Any use, modification, reproduction, release, performance, display or disclosure of the Software and accompanying documentation by the United States Government shall be governed solely by the terms of the Contract and is prohibited except to the extent expressly permitted by the terms of the Contract.

*Commentary*

"FAR" refers to the Federal Acquisition Regulations and "DFAR" to the Defense Federal Acquisition Regulations.

### 22.145.23 Catch-up licenses after overusage

a. *Background:* IF: Customer uses the Software beyond the scope of the Software License; THEN: The parties prefer to resolve the overusage on a business basis, and not as a matter of possible copyright infringement.

b. *Customer purchase obligation:* Toward that end: Customer will promptly purchase:

1. all additional licenses required for such overuse,
2. plus maintenance for such additional licenses:

    (i) for the full term of the then-current maintenance subscription for the item(s) of Software in question; or

    (ii) if longer, for the period during which the unlicensed use has been taking place.

c. *Additional license purchase:* IF: Customer *intentionally* used the Software beyond the scope of the Software License;

THEN: Customer will purchase enough additional licenses to cover all relevant license units in Customer's entire worldwide network,

including but not limited to the network(s) of Customer's affiliates (see the definition in Clause 22.2) (if any).

d. *Pricing* for catch-up license purchases under this Option will be Licensor's then-applicable list price.

e. *Additional maintenance purchase:* IF: Customer did not purchase such additional licenses on its own initiative,

THEN: As a compromise of any potential dispute over exactly how long Customer was making unlicensed use of the Software, Customer will likewise purchase one additional year of back maintenance, for all license units.

f. *Exclusive remedy possibility:* IF: Customer purchases additional licenses and maintenance as provided in this section,

THEN: That purchase will be Licensor's EXCLUSIVE REMEDY for Customer's unauthorized use of Software described in this Option;

in all other events, Licensor reserves the right, in Licensor's sole discretion, to pursue other remedies for Customer's unauthorized use,

including but not limited to remedies for copyright infringement,

to the fullest extent permitted by applicable law,

and in which case any limitations of Customer's liability in the Contract will not apply.

*Commentary*

Subdivision c: If Customer were *intentionally* to use the Software beyond the scope of the paid-for Software License, it would be inappropriate for Customer to demand that Licensor take Customer's word for it that Customer would not do so again. Consequently, subdivision d requires that Customer buy enough licenses to cover Customer's entire worldwide network.

Subdivision f: Under this exclusive-remedy clause, Licensor will be precluded from seeking damages or profits under copyright law.

- This is not an insignificant concession on Licensor's part, because in certain circumstances, Licensor would be entitled to an award of Customer's indirect prof-

its arising from the infringement, as explained in more detail in the commentary to [BROKEN LINK: pmt-ne-infr][BROKEN LINK: pmt-ne-infr][BROKEN LINK: pmt-ne-infr].

- In return for Licensor's concession, Customer makes a contractual commitment in this section to pay for catch-up licenses, and possibly back maintenance, as indicated above.

## Clause 22.146 Software Limited Warranty

### 22.146.1 Applicability; parties

This Clause applies if and when, under the Contract, a specified party ("*Provider*") warrants one or more items of computer software (of any kind, including but not limited to firmware) to another party (*"Customer"*).

### 22.146.2 Software media warranty

IF: Software and/or its documentation are delivered on physical media (for example, on a DVD or USB "thumb drive");

THEN: Those media are warranted for the specified time period after their delivery, as follows:

a. If Customer reports to Provider, within 90 days after delivery,

that the media on which the Software and/or its documentation were delivered contained material defects,

then Provider will deliver a replacement for the defective media to Customer,

at no charge to Customer.

b. Provider's obligations in subdivision a are Customer's EXCLUSIVE REMEDY for defective media.

*Commentary*

Inasmuch as software is increasingly delivered by download, not by media, this warranty seems likely to be less and less relevant.

### 22.146.3 Malware warranty & EXCLUSIVE REMEDY

All Software is warranted against malware for 90 days after delivery of the Software version in question, as follows:

a. IF: Malware (defined below) is present in any deliverable as furnished by Provider under the Contract; AND: Customer reports the malware to Provider within the specified time period; THEN: Provider is to pay, or reimburse Customer for all reasonable foreseeable expenses, actually incurred by Customer, in:

1. removing the malware; and
2. mitigating and repairing any damage caused by the malware;

other than expenses that could have been avoided if Customer had taken prudent precautions.

b. The term "*malware*" is to be interpreted as those in the computer industry would typically define it at the relevant time; in general, the term refers to computer program instructions and/or hardware designed to do one or more of the following:

1. alter, damage, destroy, disable, or disrupt the operation or use of software, hardware, and/or data;
2. disable or bypass security controls; and/or
3. allow unauthorized personnel to access data (including but not limited to personal data) and/or programming.

c. The term *malware* would normally be understood as including, without limitation, the following terms, which are reasonably well-understood in the software- and Internet industry:

adware; back doors; ransomware; rootkits; snoopware; spyware; time bomb; trap doors; Trojan horses; viruses; and worms.

d. Provider's obligations in subdivision a are Customer's EXCLUSIVE REMEDY for malware in any deliverable furnished by Provider under the Contract.

*Commentary*

See generally the Wikipedia entry Malware.

The EXCLUSIVE REMEDY words are in all-caps for conspicuousness (discussed in the commentary at Section 11.4: ).

**Caution:** Some customers might ask Provider to commit to making "best" efforts to prevent infection by viruses, etc. The trouble with that is that, if a problem were to arise, *with 20-20 hindsight* it would almost always be possible for a customer's lawyer and hired expert witness to dream up *some* additional precaution that theoretically Provider should have taken to prevent the problem, therefore Provider (supposedly) didn't use "best" efforts, Q.E.D. (See also the discussion of *best efforts* in the commentary to [NONE].)

### 22.146.4 Software performance warranty

a. Unless the Contract unambiguousy says otherwise, Provider warrants — for the period specified in [NONE] — that the Software, as delivered, will perform, in all material respects, in accordance with:

1. the user documentation for the Software that is furnished by or on behalf of Provider; and

2. any additional written specifications for the Software's performance that comply with subdivision b below.

b. Any such additional written specifications must be expressly set forth and identified as such,

in a written agreement signed by an authorized representative of Provider;

for this purpose, the term *authorized representative* does *not* include resellers or other intermediate distributors.

*Commentary*

This section and the next ones are pretty standard in the enterprise software world. (Source: Many years of experience.)

### 22.146.5 Software performance-warranty duration

a. *Performance warranty period for paid perpetual license:* If the Software is licensed to Customer under a paid, perpetual license,

then the performance warranty period stated in the heading of this section (or in the Contract) will apply;

that warranty period will begin on the date of delivery

of the first version of the Software that is so licensed to Customer.

b. *Performance warranty period for time-limited license:* IF: The Software is licensed to Customer under a time-limited license,

for example (see the definition in Clause 22.59), under a software-as-a-service ("SaaS") subscription;

THEN: The performance warranty period will be the entire period of the subscription.

### 22.146.6 Software performance EXCLUSIVE REMEDIES

a. IF: During the performance warranty period specified in [NONE], the Software does not perform as stated in [NONE]; THEN: Provider is to:

1. provide Customer with a repair, replacement, or commercially-reasonable workaround for the defective Software in accordance with [NONE] and Tango Clause 22.45 - Defect Correction; and/or

2. refund amounts paid by Customer for the defective Software, as follows:

(i) the entire amount paid for a paid, perpetual license, or

(ii) a pro-rata portion (amortized on a daily basis) of the amount paid for a time-limited license;

when this happens, Customer's right to use the Software will be automatically terminated without additional notice unless the parties unambiguously agree otherwise in writing.

b. IF: Provider is unable, after reasonable efforts, to replicate the issue reported by Customer; THEN: Provider will be deemed to have completed its repair-or-replace performance under subdivision a.1.

c. Provider's obligations in subdivisions a and b are Customer's EXCLUSIVE REMEDY for any failure of performance by the Software.

*Commentary*

The "repair, replace, or refund" remedies are pretty much the industry standard.

Subdivision b: Sometimes a software customer will have an oddball hardware- and/or software configuration that cause problems with licensed software. When that happens, the software provider can't reasonably be expected to keep throwing resources at the problem to satisfy one customer. (That said: In a situation like that, many providers will just go ahead and refund the customer's money.) See also the general warranty limitations in [NONE].

### 22.146.7 Warranty against third-party IP infringement

a. Provider warrants that the Software as delivered complies with Tango Clause 22.83 - Infringement Warranty,

subject to the limitations of that warranty, including but not limited to the remedy limitations.

b. Customer's EXCLUSIVE REMEDIES for any claim of infringement by the Software are as stated in Tango Clause 22.83 - Infringement Warranty.

### 22.146.8 Warranty service protocol

For Customer to be entitled to the remedies of this Clause, Customer must, at its own expense:

1. report a potential breach of this Clause to Provider, in writing, with reasonable detail,

no later than the end of the relevant warranty period; and

2. at Provider's request from time to time, provide Provider with reasonable information concerning the potential breach.

### 22.146.9 General warranty limitations

a. Provider DOES NOT WARRANT that the Software:—

1. will be error free;
2. will meet Customer's need; or
3. will operate without interruption.

b. Provider DOES NOT WARRANT that the Software will perform as documented in cases of:

1. hardware malfunction;

2. misuse of the Software;

3. modification of the Software by any party other than Provider — BUT this subdivision is not to be intepreted as implicitly authorizing Customer to make or have made any such modification;

4. use of the Software in an environment or with other software not described in the documentation or supported by Provider; or

5. bugs in other software with which the Software interacts.

c. THE SOFTWARE IS NOT DESIGNED OR INTENDED FOR USE IN HAZARDOUS ENVIRONMENTS REQUIRING FAIL-SAFE PERFORMANCE,

including but not limited to any application in which the failure of the Software could lead directly to death, personal injury, or severe physical or property damage,

except to the extent — if any — explicitly stated otherwise in the Contract.

## Clause 22.147 Status Conferences

a. At either party's request, the parties are to confer about the transaction(s) and/or relationship(s) that are contemplated and/or evidenced by the Contract.

b. The parties may of course discuss whatever they want, but each status conference should ordinarily include discussion of some or all of the following "*G-PP-AA*" items: • G - goals of the parties in respect of the Contract; • P - progress to date in achieving those goals; • P - problems encountered or anticipated; • A - action plans for the future, including but not limited to action plans for addressing existing or an-

ticipated problems and opportunities; and • A - assumptions being made, especially assumptions that might turn out to be unwarranted.

*Commentary*

This status-conference requirement recognizes that many business disputes could be mitigated, or even avoided entirely, if the parties would just talk with each other once in a while. This is basically "Management 101," but making it a contractual *requirement* also gives each party an incentive not to ignore or brush off the other party.

It's often extremely helpful to hold status conferences immediately after (better yet, before) a missed deadline or other potential breach.

In some situations, the parties might want to specify quarterly–, monthly–, or even weekly calls.

## Clause 22.148 Subject to Contract Definition

If a document states that particular discussions are "subject to contract," the document thereby incorporates [NONE] by reference.

## Clause 22.149 Support Levels Definition

a. A party that commits to providing *Level 1 support* is responsible for routine basic support for a product or service; it entails providing customers, where applicable, with:

1. compatibility information,
2. installation assistance,
3. general usage support,

4. assistance with routine maintenance; and/or

5. basic troubleshooting advice.

b. A party that commits to *Level 2 support* is is responsible more-in-depth attempts to confirm the existence, and identify possible known causes, of a defect in a product or an error in a service that is not resolved by Level 1 support.

c. A party that commits to providing *Level 3 support* is is responsible for providing advanced efforts to identify and/or correct a defect in a product or an error in a service.

*Commentary*

See generally, e.g.:

- Chrissy Kidd and Joe Hertvik, IT Support Levels Clearly Explained: L1, L2, L3, and More (BMC.com 2019)
- Wikipedia, Technical support

## Clause 22.150 Survival of terms

a. IF: This Clause is agreed to; THEN: All provisions of the Contract in the categories listed in this Clause will continue in effect beyond any termination or expiration of the Contract.

b. The surviving provisions are those (if any) concerning:

arbitration;

attorney fees;

confidentiality;

early neutral evaluation;

expense-shifting after settlement-offer rejection;

forum selection (or choice of forum);

governing law (or choice of law);

indemnification;

insurance requirements;

intellectual-property ownership;

limitations of liability;

non-competition;

non-solicitation;

remedy exclusions and -limitations;

representations and warranties;

warranty disclaimers;

warranty rights.

c. In addition, all provisions of the Contract relating to the recovery of attorney fees and other dispute expenses will survive the entry of a judgment, arbitration award, or other decision in a contested proceeding. Further reading: Commentary

*Commentary*

Drafters should be careful about what rights and obligations would survive termination.

See generally Jeff Gordon, Night of the Living Dead Contracts.

**Caution:** Some agreements include a survival provision along the following lines: *All other provisions of the Agreement that, by their nature, should extend beyond termination or expiration of the Agreement will survive any such termination or expiration.* Such language, however, could be dangerously vague.

## Clause 22.151 Tax Responsibility

### 22.151.1 Sales- and value-added taxes

a. An invoicing party must timely *report* and *remit*, to the appropriate authorities, all *sales* taxes, value-added taxes, and similar taxes required by law for the matter(s) being invoiced (if any).

b. In case of doubt: The invoicing party need *not* report, nor remit, any use- or consumption taxes for the matter(s) being invoiced.

*Commentary*

A customer will normally want its vendors to take care of any necessary sales taxes — but for *use* taxes, It likely will make more sense for the customer itself to handle the necessary "paperwork" (which nowadays is likely to be done over the Internet, of course). See generally Sales tax (Wikipedia.org) (includes links for value-added taxes and use taxes).

### 22.151.2 Income tax responsibility

No party is to look to any other party to the Contract to pay or reimburse taxes based on, or computed from, the first party's income.

*Commentary*

It's not uncommon for contracts to state explicitly that each party is responsible for its own income taxes; presumably this practice arose because at some point, some aggressive party tried to get another party to pay or reimburse the first party's income taxes.

Of course, in some cases, it might be part of the bargain for one party to "gross up" its payments to another party, so that the payee's net amount received, after income taxes, is equal to a stated amount. See generally Grossing up (Investopedia.com).

### 22.151.3 Drawback paperwork

a. As between an invoicing party and a payer, all drawbacks (if any) belong to the payer.

b. IF: The payer so requests; THEN: The invoicing party will provide the payer with all paperwork reasonably requested by the payer to help the payer to claim any available drawbacks, such as certificates of origin and the like,

at no extra charge,

IF the invoicing party can do so without undue burden or expense.

*Commentary*

This section draws on ideas seen in § 2.4 and § 8 of a Honeywell purchase order form archived at https://perma.cc/CUV6-NKTY.

*What are "drawbacks"?* In the global economy, goods are often manufactured in stages in various countries. For example, aluminum components in a car might have started out as bauxite that, as one author put it, is "mined and refined in Jamaica, shipped to northern Quebec for smelting, then hammered into car parts in Alcoa, Tenn."

> Binyamin Appelbaum, American Companies Still Make Aluminum. In Iceland., *New York Times*, July 2, 2017, section BU, at 1 (NYTimes.com).

Each destination country might charge an import fee in an attempt to protect the local economy. Many countries, however, will refund some or all of the import fee *upon request* if the relevant imports are used, for example, in local factories employing local workers. These refunds are sometimes referred to as "drawbacks." **A drawback is**, according to one explanation, "[a] partial refund of an import fee. Refund usually results because goods are re-exported from the country that collected the fee."

> Supply Chain Glossary (scm-portal.net).

*Collecting* a drawback usually entails filing administrative paperwork, not unlike filing for a tax refund, with documentation sufficient to convince local authorities that the drawback is authorized by local law.

### 22.151.4 Indemnity obligation for tax-related claims

Each party is to defend (as defined in Clause 22.46) each other party's Protected Group (as defined in Clause 22.126) against any claim by a third party,

> including but not limited to claims by any taxing authority (see the definition in Clause 22.151.5),
>
> that the protecting party failed to pay any tax (see the definition in Clause 22.151.5) — of any kind, not just income taxes — for which the protecting party was legally responsible, whether that responsibility arose under the Contract or otherwise.

*Commentary*

When tax authorities believe taxes to be due in connection with a transaction, they've been known to try to collect the taxes from anyone involved in the transaction. If the Contract has allocated responsibility for tax reporting and payment, the non-responsible parties will likely want the responsible party to step up and deal with any actions by taxing authorities; hence, this section.

### 22.151.5 Definitions: Tax; Sales Tax; Taxing Authority

a. The term *tax* refers to any tax, assessment, charge, duty, levy, or other similar governmental charge of any nature, imposed by any government authority.

b. The term *tax*, however, does not encompass a price charged by a government authority for (i) services rendered, nor (ii) goods or other assets sold or leased, by the government authority.

c. The commentary to this section lists illustrative examples of taxes, whether or not an obligation to pay the same is undisputed, and whether or not a return or report must be filed.

*Commentary*

Examples of taxes include, without limitation:

a. taxes on:

- income;
- gross receipts;
- employment;
- franchise;
- profits;
- capital gains;
- capital stock;
- transfer;
- sales;
- use;
- occupation;
- property;
- excise;

- severance;
- windfall profits;
- sick pay;
- or disability pay;

b. ad valorem taxes;

- alternative minimum taxes;
- environmental taxes;
- license taxes;
- payroll taxes;
- registration taxes;
- social security (or similar) taxes;
- stamp taxes;
- stamp duty reserve taxes;
- unemployment taxes;
- value added taxes;
- or withholding taxes; and

c. all other taxes;

- assessments;
- charges;
- customs and other duties;
- fees;
- levies;
- or other similar governmental charges of any kind; and

d. all estimated taxes;

- deficiency assessments;
- additions to tax;
- and fines, penalties, and interest on past-due tax payments.

a. The term "*taxing authority*," whether or not capitalized,

- refers to any government authority exercising *de jure* or *de facto* power
- to impose, regulate, or administer or enforce the imposition of taxes.

b. The term "*sales tax,*" whether or not capitalized, includes (without limitation) all of the following:

1. sales taxes;
2. use taxes;
3. value-added taxes;
4. excise taxes;
5. other forms of ad valorem tax and consumption tax;
6. and equivalent taxes.

For many contracts, defining *tax* and related terms might be overkill, but this section provides a definition "just in case."

This definition draws on the following:

• the contract language quoted by the Court of Appeals of New York in upholding a summary judgment that a $20 million-plus water usage charge, levied by a Mexican government entity, was a "tax" within the meaning of the contract's laundry-list definition; and

See Innophos, Inc. v. Rhodia, S.A., 10 N.Y.3d 25, 27-28 (2008

• section 3.5(e) of an Asset Purchase Agreement between Piper Jaffray Companies and UBS Financial Services.

This Asset Purchase Agreement is reproduced in David Zarfes & Michael L. Bloom, Contracts and Commercial Transactions (Wolters Kluwer Law & Business 2011).

## Clause 22.152 Termination

*Provisions whose headings begin with "Option:" do not apply in the Contract unless the Contract unambiguously states otherwise.*

Contents:

### 22.152.1 Termination for *material* breach

Either party may terminate for Either party may terminate (i) the Contract, and/or (ii) an order under the Contract,

> for material breach (see the definition in Clause 22.102.2), by the other party, of the other party's obligations under the Contract,
>
> in accordance with this Clause.

*Commentary*

#### *22.152.1.1 Is a termination-for-breach clause necessary?*

A Texas appeals court recapped standard law on how a *material* breach — but not a *nonmaterial* breach — will excuse *future* performance by the other party; the court also explained what constitutes a "material" breach:

> A material breach by one party to a contract can excuse the other party from any obligation to perform *in the future*.

> A *material* breach is conduct that deprives the injured party of the benefit that it reasonably could have anticipated from the breaching party's full performance.
>
> By contrast, when a party commits a *nonmaterial* breach, the other party is *not* excused from future performance, but may sue for the damages caused by the breach.

Earth Power A/C and Heat, Inc. v. Page, 604 S.W.3d 519, 524 (Tex. App.–Houston [14th Dist.] 2020) (reversing and rendering to restore jury verdict, awarding attorney fees to contractor per contract) (edited).

#### *22.152.1.2 Do you really want to terminate the contract?*

Drafters should think about whether termination *of the Contract* is what they have in mind. People routinely refer to termination *of a contract*, but what they really *might* mean (and sometimes *should* mean) is the termination of *specific rights and obligations* under the contract.

(This possibility is covered in [NONE] below.)

#### *22.152.1.3 Caution: Don't do an own-goal termination*

Improper termination of a contract for breach could itself be an "own goal" breach of contract.

> Own goal: "1 *chiefly British* : a goal in soccer, hockey, etc., that a player accidentally scores against his or her own team [¶] 2 *chiefly British* something that one does thinking it will help him or her but that actually causes one harm" (Merriam-Webster.com)

Imagine this: • You want to get out of a contract. • You conclude that the other side has materially breached the contract. • You send a notice of breach, but the other side fails to cure the breach (or perhaps you claim that the breach is incurable). • So, you send a notice of termination. • But then a court holds that the other party's breach wasn't "material" after all; aAs a result, you didn't have the right to terminate — and so *your termination* was a repudiation, *and thus a breach in itself*.

• This was the result in an Arkansas case, where the party that terminated a contract was held liable for millions of dollars in damages for doing so.

> See Southland Metals, Inc. v. American Castings, LLC, 800 F.3d 452 (8th Cir. 2015) (affirming judgment on jury verdict).

• Likewise, Hess Energy terminated a contract for what it claimed was a material breach, but the appellate court held that the breach *wasn't* material — and this, said the appellate court, assumed that the other party's actions were a breach at all; So, said the appellate court, the alleged breach didn't justify Hess's termination.

> See Hess Energy Inc. v. Lightning Oil Co., 276 F.3d 646, 649-51 (4th Cir. 2002) (reversing summary judgment). The *Hess* case is also discussed at § 22.152.1.5, concerning assignment without consent as a material breach.

• In a Houston case, a geothermal HVAC contractor breached a contract with a homeowner, whereupon the homeowner stopped paying the contractor. A jury

found that both parties had thereby breached. *But*: The contractor's prior breach didn't excuse the homeowner's failure to pay, because (said the appeals court) the evidence did not conclusively establish *the materiality* of the contractor's breach. Consequently, the homeowner was still on the hook to pay the contractor, despite the contractor's prior breach.

Earth Power A/C and Heat, Inc. v. Page, 604 S.W.3d 519, 524 (Tex. App.–Houston [14th Dist.] 2020) (reversing and rendering to restore jury verdict, awarding attorney fees to contractor per contract) (edited). The appeals court also ordered the homeowner to pay the contractor's attorney fees, as required by the contract.

#### *22.152.1.4 Pro tip: Don't refer to "the non-breaching party"*

If a contract authorizes a party to terminate because of the other party's breach, the authorization should refer to that party as "the terminating party" or "the other party," *not* as "the non-breaching party." That's because in one case, the contract's termination-for-breach provision referred to the right *of the non-breaching party* to terminate. That, said the court, meant that the party that had purported to terminate the contract did not have the power to do so — because *that* party was itself in breach, of a different contract provision.

See Powertech Tech., Inc. v. Tessera, Inc., No. C 11-6121 CW, slip op. at part I.A (N.D. Cal. Jan. 15, 2014) (on summary judgment).

#### *22.152.1.5 Termination: To chase after another partner?*

A party might look for a supposed material breach of contract as a fabricated excuse to terminate that contract and take up with another, more-lucrative party. That motivation seems to have been at work in the *Hess Energy* case cited above.

See Hess Energy Inc. v. Lightning Oil Co., 276 F.3d 646, 649-51 (4th Cir. 2002) (reversing summary judgment and remanding for determination of Statoil/Hess's damages).

Another example — one that would be even more egregious if the allegations were true — comes from a Seventh Circuit case involving Bimbo Foods, part of a Mexican multinational corporation:

> According to JTE's complaint, which we must accept as true for purposes of this appeal, Bimbo Foods began fabricating curable breaches in the spring of 2008 as part of a scheme to force JTE out as its distributor.
>
> • Bimbo Foods employees filed false reports of poor customer service and out-of-stock products at stores in JTE's distribution area.
>
> • Even more egregiously, Bimbo employees would sometimes remove JTE-delivered products from grocery store shelves, photograph the empty shelves as "proof" of a breach, and then return the products to their initial location.
>
> • On one occasion, in 2008, a distributor caught a Bimbo Foods manager in the act of fabricating a photograph and reported him.
>
> Bimbo assured JTE that this misconduct would never happen again. Nevertheless, unbeknownst to JTE, Bimbo Foods continued these scurrilous tactics.

> [Bimbo's] goal was to force JTE to forfeit its distribution rights so that Bimbo Foods could install a new distributor that would take a smaller slice of the proceeds: 18 percent as compared to JTE's 22 percent.
>
> When JTE refused to sell its distribution rights in January 2011, Bimbo Foods breached the distribution agreement and unilaterally terminated JTE's agreement, citing the fabricated breaches as cause.
>
> Several months later, in September and October 2011, Bimbo Foods forced JTE to sell its rights to new distributors.

Heiman v. Bimbo Foods Bakeries Distrib. Co., 902 F.3d 714 (7th Cir. 2018) (affirming dismissal of JTE's complaint on statute-of-limitation grounds) (emphasis and extra paragraphing added).

### 22.152.2 Two notices (usually) required for termination

a. To terminate for breach, the terminating party must do the following:

1. give the breaching party notice *of breach*, stating at least:

(i) the circumstances of the breach, in reasonable detail; and

(ii) the duration of the specific cure period that the terminating party believes to be applicable, if any, as set forth below;

2. wait for the cure period, if any (see below), to end; and

3. give the breaching party notice *of termination* if the (curable) breach has not been cured by the end of the cure period;

b. The notice of termination must describe, with reasonable specificity:

a. the basis for termination, and

b. the putative effective date of termination.

a. If the breach is incapable of cure, then the notice of breach and notice of termination may be the same notice.

*Commentary*

#### *22.152.2.1 Notice of termination should be clear*

A notice of termination should be clear that it is *a termination notice*. Neither the terminating party nor the non-terminating party will want to have to litigate whether a particular communication qualified as a termination notice. That was the unfortunate result in a First Circuit case, where:

- a drywalling company had a collective bargaining agreement ("*CBA*") with a carpenter's union;
- the CBA gave the union's right to audit the company's contributions to various pension funds, etc.;
- the company sent the union a letter stating that the company was no longer doing any union work;
- the union asked for a final audit of the company's contributions, but the company refused;
- the union sued the company to get the final audit — but the court found that the company's letter had the effect of terminating the CBA, and that the union's audit right died with the CBA.

  See New England Carpenters Central Collection Agency v. Labonte Drywall Co., 795 F.3d 271 (1st Cir. 2015). The present author personally disagrees with the court's analysis, but no one has asked me for my opinion on the matter ….

The unfortunate part is that the company and the union had to litigate the issue; they might not have had to incur quite as much expense and inconvenience if the company's letter had been more explicit that the company was terminating the CBA.

*Language choice: "Terminating party"*

This provision uses the term "terminating party" instead of the more-common "non-breaching party," for reasons discussed at Section 22.152.1.4: .

### 22.152.3 Cure periods

The cure period for a breach will be as follows, beginning upon the effective date of the other party's notice of breach:

1. *Nonpayment* of an amount due under the Contract: Five business days.
2. *Missed deadline* for which the Contract umambiguously states, in effect, that time is of the essence (see the definition in Clause 21.18): No cure period.
3. *Other, curable missed deadline* stated in the Contract: Five business days.
4. *Other, curable breach:* Ten business days.
5. *Breach that clearly is not capable of being cured:* No cure period; immediate termination is allowed.

*22.152.3.1 Commentary*

These cure periods are fairly typical of those in negotiated contracts.

**Pro tip:** Try to avoid one-size-fits-all cure periods, e.g., 30 days after the notice of breach.

### 22.152.4 Termination of transaction, etc., instead

In lieu of terminating the Contract, a party authorized to terminate the Contract may instead terminate one or more of the following specific items, to the extent that such items exist under the the Contract:

1. transactions, for example, a purchase order or a statement of work for services;
2. grants, for example, a lease or license;
3. relationships, for example, a distributorship; and/or
4. exclusivity of a grant.

*Commentary*

Drafters should consider whether they really want to give a party the right to terminate the Contract, as opposed to specific rights and obligations, as discussed in Section 22.152.1.2: .

### 22.152.5 Later reliance on other termination grounds

IF: A party terminates the Contract (or a transaction or relationship under the Contract) for a stated reason;

BUT: The stated reason later is found not to have been applicable;

THEN: The termination is to be deemed to have been made for any other reason that would have warranted or allowed termination under the Contract.

*Commentary*

This language provides a terminating party with a backup position in case its original reason for termination doesn't pan out. That might be handy to keep the original termination from being held to have been *itself* a breach of contract, as happened, for example, in an Arkansas case.

See Southland Metals, Inc. v. American Castings, LLC, 800 F.3d 452 (8th Cir. 2015) (affirming judgment on jury verdict), discussed in

### 22.152.6 Termination not exclusive remedy for breach

Unless the Contract expressly states otherwise, termination will not be the terminating party's exclusive remedy for the breach(es) that led to termination.

*Commentary*

This is a "roadblock" provision that parties sometimes want in their contracts.

### 22.152.7 Post-termination performance

The Contract may require one or more parties to take certain actions, or to have other rights or obligations, upon a termination.

*Commentary*

*Every* contractual relationship will come to an end — sometime, somehow. Contracts therefore should plan for orderly shutdowns.

In planning for an orderly shutdown, a contract drafter should consider what actions the drafter's client might want to require the other party to take.

Such post-termination actions could include, for example, the following:

- final deliveries of:
  - goods;
  - intangibles, e.g., reports;
  - work in progress;
- issuance of final invoices;
- payment of outstanding amounts;
- return of confidential information, if applicable (see [NONE]);
- continuing confidentiality obligations (see [NONE]);
- preparation and signing of intellectual-property assignment documents (see [NONE]);
- a provider's obligation to help a customer transition to another provider (cf. § 22.139.29).

### 22.152.8 The Contract may restrict termination at will

a. This section does not in itself authorize, nor prohibit, termination at will.

(For this purpose, the terms *termination at will* and *termination for convenience* are considered synonyms.)

b. The Contract may include agreed restrictions on a party's right to terminate at will.

c. Absent a clear restriction in the Contract, a party that is otherwise entitled to terminate at will may do so:

at any time, and

in the terminating party's sole discretion (see the definition in Clause 22.49).

*Commentary*

Parties to a contract sometimes want to know what their options are for "pulling the plug" even in the absence of breach; this is known as "termination at will" or sometimes "termination for convenience."

Termination at will by one party can leave another party in the lurch, so it might be appropriate for a contract to limit the parties' right to terminate at will, as discussed in the next few subsections.

#### *22.152.8.1 Termination at will might be available by law …*

Under the law in the U.S., an **ongoing** contract *that does not include its own end date* will usually be considered terminable at will "upon reasonable notice to the other party after a reasonable time has passed"; moreover, "In general, contracts of *perpetual* duration are disfavored as a matter of public policy; thus, while we will enforce a contract that *unambiguously* expresses an intent to be of perpetual duration, we construe *ambiguous* language regarding duration *against* perpetual duration."

> Glacial Plains Coop. v. Chippewa Valley Ethanol Co., LLLP, 912 N.W.2d 233, 236, 237 (Minn. 2018) (citing cases; emphasis added). More citations: Glenn West, Forever is a Long Time or No Time at All (JDSupra.com 2019), https://perma.cc/8DPL-UHQY.

#### *22.152.8.2 … but that right might need contractual "fences"*

**Caution:** A party that will be making a significant investment of time or money in the Contract might want to try to negotiate restrictions on the other party's right to terminate at will, so as to allow the investing party at least some minimum time in which to try to recoup at least some part of that investment.

1. imposing a minimum advance notice requirement;

2. allowing termination at will only, for example:

   after a certain amount of time has elapsed;

   after one or another party has achieved specified performance targets;

   if the terminating party pays a specified buyout fee; and/or

   for good reason (preferably but not necessarily specified in the Contract).

An article co-authored by an economics Nobel laureate points out that:

> Termination-for-convenience clauses create perverse incentives for suppliers to not invest in buyer relationships. "A 60-day termination for convenience translates to a 60-day contract," one CFO at a supplier told us. "It would be against our fiduciary responsibility to our shareholders to invest in any program for a client with a 60-day termination clause that required longer than two months to generate a return." The implications for innovation are obvious. "Buyers are crazy to expect us to invest in innovation if they do the math."
>
> David Frydlinger, Oliver Hart, and Kate Vitasek, A New Approach to Contracts, Harv. Bus. Rev., Sept.-Oct. 2019, archived at https://perma.cc/T2TJ-3ENN.

The law, however, might provide such contractual fences; as the Second Circuit noted about New York law:

> Under New York law, it is well settled that a contract of indefinite duration is terminable at will unless the contract states expressly and unequivocally that the parties intend to be perpetually bound. … If it appears that no termination date was within the contemplation of the parties, or that their intention with respect thereto cannot be ascertained, the contract will be held to be terminable within a reasonable time or revocable at will . . . . Contracts of exclusive agency and distributorship are terminable at will in the absence of an express provision of duration. … * * *

> … *In some circumstances, New York law imposes a reasonable-duration requirement on exclusive distribution agreements* that are otherwise terminable at will. Such a requirement *may* arise in circumstances such as these where a distributor must invest in equipment, materials, and other assets to perform its obligations under the contract.
>
> Compania Embotelladora Del Pacifico, S.A. v. Pepsi Cola Co., 979 F.3d 239, 245, 246 (2d Cir. 2020) (affirming summary judgment in favor of PepsiCo) (cleaned up, citations omitted, emphasis added).

#### *22.152.8.3 Termination at will might be prohibited by law*

As an example, the Minnesota Termination of Sales Representatives Act, Minn. Stat. § 325E.37 imposes restrictions on a manufacturer's right to terminate a sales representative.

> See Engineered Sales Co. v. Endress + Hauser, Inc., No. 19-1671 (8th Cir. Nov. 17, 2020) (reversing and remanding summary judgment).

And some *countries* might restrict a party's right to terminate a contract.

> See, e.g., Alexandre Bailly and Xavier Haranger, What to Know When Terminating Contracts Governed by French Law or Involving French Parties (MorganLewis.com 2020), archived at https://perma.cc/4QB4-5BV9.

### 22.152.9 Effects of termination

To the extent not manifestly inconsistent with mandatory applicable law, any termination would:

1. cancel the parties' relevant, respective, post-termination rights and obligations, except to the extent (if any) that the Contract provides otherwise — for example in a survival provision;

2. cancel any right a party has to continue performance of its relevant pre-termination obligations;

3. not affect any claim, by any party, for pre-termination breach by another party; and

4. be without prejudice to any party's other rights or remedies except to the extent, if any, that the Contract clearly provides otherwise.

*Commentary*

Subdivision 1 – cancelation of right to perform: This subdivision is inspired by a Michigan case in which the state supreme court's recitation of facts noted that "Miller-Davis gave Ahrens notice of default, *terminated Ahrens's right to perform the contract*, and demanded the bonding company perform under the bond."

> Miller-Davis Co. v. Ahrens Constr., Inc., 495 Mich. 161, 848 N.W.2d 95, 99 (2014) (emphasis added).

In other words, in that case the contractor was fired and presumably was replaced by another contractor hired by the bonding company — presumably at the original contractor's expense, which almost surely cost the original contractor more than just finishing the job would have cost it.

### 22.152.10 No liability for termination itself (normally)

a. Neither party will owe another party money,

solely because of termination of the Contract in accordance with its termination provisions,

unless the Contract clearly specifies otherwise,

for example (see the definition in Clause 22.59), in a provision for an early-termination fee.

b. This section, however, does not mean that a party might not owe money:

1. under other provisions of the Contract; or

2. for breach of an obligation under the Contract; or

3. for *wrongfully* terminating the Contract when the terminating party was not entitled to do so.

### 22.152.11 Expiration counts as a type of termination

a. Any expiration of the term of the Contract,

or, if applicable, expiration of a transaction, grant, or relationship under the Contract),

will have the same effect as a termination,

unless otherwise unambiguously clear from the context.

b. For this purpose, the term *expiration* includes, without limitation, expiration due to a party's exercising a right to opt out of an automatic-

extension provision.

c. A notice of an upcoming expiration is not needed for the expiration to be effective unless the Contract clearly requires otherwise.

### 22.152.12 Option: Termination After Certain Personnel Changes

a. If this Option is agreed to, then a party specified in the Contract (a "*terminating party*") may terminate the Contract,

> or a related transaction or relationship, e.g., a statement of work for services,
>
> following any change, of a type expressly specified in the Contract, among the personnel of the other party.

b. If not sooner exercised, this right to terminate will expire at the earlier of:

a. 90 days after the date that the terminating party first learns, via any source, of the most-recent personnel change in question; or

b. six months after the most-recent personnel change in question.

*Commentary*

This provision might be used in a contract with a small company or startup company whose ability to continue to perform might be called into question if too many senior- or key people were to leave.

Subdivision b – expiration of termination right: This provision follows the maxim that rights and obligations should generally have a "sunset," so as not to be indefinitely hanging over other parties' heads.

### 22.152.13 Option: Termination Upon Change of Control

a. If this Option is agreed to, then any party (each, a "*terminating party*") may terminate the Contract following a change of ownership of the power to vote more than 50% of the voting power entitled to vote for members of the other party's board of directors (or equivalent body in a non-corporate organization).

b. If not sooner exercised, the right to terminate under this Option will expire at the earlier of:

a. 90 days after the date that the terminating party first learns, via any source, of the change; or

b. six months after the effective date of the change of control.

*Commentary*

This Option has in mind that a party might not want to continue doing business with a counterparty if, say, the counterparty was acquired by one of the first party's competitors. (For this purpose, the parties might want to specify a different definition of *control*.)

Subdivision b – expiration of termination right: This provision follows the maxim that rights and obligations should generally have a "sunset," so as not to be indefinitely hanging over other parties' heads.

• The 90-day termination period forces the terminating party to make up its mind; the termination period starts when the terminating party first learns of the change of control, as opposed to when the other party gives notice of the change of control. The terminating party might prefer it to be the other way around, but that might be too burdensome for the other party to manage.

• The six-month limit has in mind that if the terminating party hasn't seen fit to terminate within that time — for example, because it hasn't noticed any ill effects from a change of control — then the right to terminate should lapse, so that the other party won't continue to have the threat of termination hanging over its head for what has become old news.

### 22.152.14 Option: Termination Damages WAIVER

If this Option is agreed to, then for the avoidance of doubt:

a. Upon any *termination* of the Contract, whether or not the termination was allegedly wrongful, the non-terminating party will not have, and may not assert or maintain, any claim for the termination *per se* against the terminating party, nor against any member of the terminating party's Protected Group (see the definition in Clause 22.126).

b. Upon any *expiration* of the Contract, no party will have, and no party may assert or maintain, any claim for the termination *per se* against any other party, nor against any member of that other party's Protected Group.

*Commentary*

The author once read, but now cannot locate, a case in which a party had allowed the term of an agreement to *expire*. In the ensuing lawsuit, the other party tried

(unsuccessfully, if memory serves) to recover damages that it claimed to have suffered as a result of the expiration. This Option attempts to forestall such a claim.

### 22.152.15 Option: Termination for Insolvency

a. If this Option is agreed to, then a party specified in the Contract (a "*terminating party*") may terminate the Contract (or a related transaction or relationship, e.g., a statement of work) for insolvency if another party to the Contract:

1. ceases to do business in the normal course;

2. becomes insolvent;

3. admits in writing its inability to meet its debts or other obligations as they become due;

4. makes a general assignment for the benefit of creditors;

5. files a voluntary petition for protection under the bankruptcy laws or similar laws of the relevant jurisdiction, or to effect a plan or other arrangement with creditors;

6. has a receiver, administrative receiver, administrator, liquidator, trustee in bankruptcy, or similar functionary in the relevant jurisdiction, appointed for its business or assets; or

7. becomes the subject of an involuntary petition under the bankruptcy laws, or a similar petition or other filing under the laws of the relevant jurisdiction, and the same is not vacated, released, dismissed, stayed, reversed or otherwise overturned, or bonded off before the end of 60 days after the date of the petition or other filing.

b. A terminating party's right to terminate for insolvency under this Option will expire at the end of 90 days after the date that the terminating party first learns, via any source, of the most-recent event listed in this Option.

*Commentary*

**Caution:** In the U.S., some of these provisions will be unenforceable as so-called "ipso facto" clauses if the non-terminating party has filed a petition for protection under the bankruptcy laws. In fact, under the Bankruptcy Code, the filing of such a petition creates an automatic stay against many forms of contract termination or other action that could jeopardize the orderly reorganization or liquidation of the party seeking protection (known as the "debtor").

See Robert L. Eisenbach III, Are "Termination On Bankruptcy" Contract Clauses Enforceable? (Cooley.com 2007), https://perma.cc/PV6N-VFTC.

As an "in the wild" example of such a provision, see a Honeywell purchase-order form at http://perma.cc/CUV6-NKTY:

> The solvent party may terminate this Purchase Order upon written notice if the other party becomes insolvent or if any petition is filed or proceedings commenced by or against that party relating to bankruptcy, receivership, reorganization, or assignment for the benefit of creditors.

Subdivision b — deadline for termination: This "sunset" provision will force the terminating party to fish or cut bait, and thus avoid leaving the threat of termination hanging over the other party's head.

### 22.152.16 Option: Termination for Legal Violation

a. If this Option is agreed to, then a specified party (a "*terminating party*") may terminate the Contract (or a related transaction or relationship, e.g., a statement of work) if another party commits any act or omission that satisfies all three of the following prerequisites:

1. The act or omission it is material to the other party's rights or responsibilities under the Contract;

2. the act or omission violates any applicable law; and

3. because of the violation, the act or omission is likely to materially and adversely affect the other party.

b. IF: the Contract clearly and affirmatively states that violations of law may be cured; THEN: a terminating party may not terminate the agreement for violation of law if both the violation and all effects of the violation are cured before the end of five business days after the violation began. OTHERWISE: The terminating party may terminate the Contract without giving the violating party an opportunity to cure the violation.

c. The right to terminate under this Option will expire if it is not exercised on or before the date 90 days after the date that the terminating party first learned, via any source, of the most-recent act or omission giving rise to the right to terminate.

*Commentary*

Subdivision c is a "sunset" provision will force the terminating party to fish or cut bait, and thus avoid leaving the threat of termination hanging over the other party's head.

### 22.152.17 Option: Termination Right is Not Waivable

IF: Following any termination or expiration of the Contract, one or both parties engages in conduct contemplated by the Contract — for example, if the parties continue to do business with each other in accordance with the terms of the Contract; THEN: Such conduct by one or both parties is not to be construed:

1. as a waiver of the termination or expiration of the Contract (as applicable), nor

2. as an extension or continuation of the term of the Contract beyond the period specified in a notice of termination, if applicable.

### 22.152.18 Option: Termination for Reputation Risk

a. If this Option is agreed to, then any party, referred to for this purpose as "ABC," may terminate the Contract if ABC reasonably determines that:

one or more Reputation Risk Actions, defined in subdivision e below,

when taken by (i) another signatory party to the Contract, referred to for this purpose as "XYZ," or (ii) an affiliate of XYZ,

are likely to create a not-insubstantial risk to the business reputation of ABC or any affiliate of ABC.

b. ABC's right to terminate for reputation risk will expire (if not sooner exercised) at 12 midnight at the end of the day on the date 90 days after the date that ABC first learned, via any source, of the most-recent Reputation Risk Action.

c. This Option establishes only a conditional right to terminate the Contract; in itself it does not obligate any party in any way.

d. XYZ will not be liable *under the Contract*, in damages or otherwise, for any Reputation Risk Action that does not otherwise breach the Contract — but this does not rule out possible XYZ liability on other grounds (for example, for tortious behavior and/or criminal action).

e. For this purpose, "Reputation Risk Action" refers to any action (for this purpose including omissions) or series of actions, whether related or unrelated, where the action is (i) intended by the actor, or (ii) reasonably likely, to do one or more of the following:

1. libel or slander another person;

2. put another person in a false light;

3. threaten, embarrass, harass, or invade the privacy of another;

4. impersonate another or promote, encourage, or assist in, such impersonation;

5. offend a reasonable person on racial- or ethnic grounds;

6. engage in conduct prohibited by law, including for example the U.S. Foreign Corrupt Practices Act;

7. encourage activities prohibited by law, including (for example) bribery; identity theft; child pornography; and terrorism;

8. engage in tortious conduct; and/or

9. mistreat a person, or promote, assist in, or encourage such mistreatment.

*Commentary*

In today's global economy, "offshore" companies do a great deal of manufacturing for U.S. and European firms. Those companies might not always comply with First-World standards of safety, employee treatment, and the like, which could result in adverse publicity for the offshore companies' customers.

For example:

• Apple and HP were forced to deal with news stories about worker suicides in factories owned by the giant Chinese electronics contract manufacturer Foxconn.

• Walmart and other retailers were confronted with a similar problem when a clothing factory in Bangladesh burned, killing over 100 people.

• Walgreens ended its relationship with troubled blood-testing company Theranos (NYTimes.com).

• In 2015, the Twin Peaks restaurant organization terminated the franchise of a restaurant in Waco, Texas, after a shootout between rival motorcycle gangs left nine dead.

See, e.g., this news story.

• Car manufacturer Hyundai terminated one of its dealerships because the New York attorney general had obtained a court judgment against the dealership for having engaged in fraudulent and illegal business practices.

Giuffre Hyundai, Ltd. v. Hyundai Motor America, 756 F.3d 204 (2d Cir. 2014).

• Longtime Subway sandwich shop pitchman Jared Fogle agreed to plead guilty to child-pornography charges, among others. Subway had previously suspended its re-

lationship with Fogle. The case, along with the attendant bad publicity for the already-troubled Subway, is a sad reminder of the value of including an appropriate "termination for business-reputation risk" clause in a contract of that nature.

Subdivision 2: This "sunset" period forces the terminating party to make up its mind – to fish or cut bait (or fill in your own metaphor).

Subdivision 5: This "laundry list" of actions that could lead to termination is adapted from language used in a number of on-line terms of service collected by Zachary West in his blog posting, Morality clauses in domain registration (zacwe.st 2011).

### 22.152.19 Termination options: Other drop-in language

None of the following options will apply except to the extent, if any, that the Contract unambiguously says otherwise; blank ballot boxes ☐ below, if any, are intended to signal this visually.

☐ Any party entitled to terminate one transaction, grant, or relationship for material breach (see the definition in Clause 22.102.2) by the other party may in its discretion terminate some or all other uncompleted transactions, grants, or relationships between the parties.

☐ No party may terminate or rescind the Contract, no matter what the circumstances, except as expressly provided in the Contract.

☐ No party may terminate or rescind the Contract, no matter what the circumstances; in case of breach of the Contract by the other party, that party's sole remedy will be an action at law for damages, and any purported termination will be of no effect.

## Clause 22.153 Termination Wrap-Up

*Commentary*

This Clause provides parties with a way for, say, a reseller of "widgets" to wind up its then-pending sales deals with end customers if the reseller's contract with the widget manufacturer comes to an end.

### 22.153.1 Applicability

If this Clause is agreed to, it applies whenever both of the following are true:

1. a specified relationship, authorization, or grant of rights, governed by the Contract (referred to generically as the "*Relationship*"), comes to an end, whether by expiration or termination; AND

2. the Contract states that a party will have time after the end of the Relationship in which to wrap up any pending business (the "*Wrap-Up Period*").

### 22.153.2 Time period for wrapping up pending business

The Wrap-Up Period: • will *begin* on the date that the Relationship formally comes to an end; and • will *end* at the end of the day on (i) the date ten business days thereafter, or (ii) such other date as may be specified in the Contract or otherwise explicitly agreed in writing.

*Commentary*

This length of time is a placeholder; the exact length of time will very likely be a subject of negotiation.

### 22.153.3 No wrap-up if material breach

A party will not have a Wrap-Up Period if that party is in material breach (see the definition in Clause 22.102.2) of the Contract when the Relationship ends.

*Commentary*

The reason for this one should be apparent.

### 22.153.4 Allowable wrap-up activities

A party entitled to a Wrap-Up Period may attempt to complete any then-pending transactions that would have been authorized by the Contract before the end of the Relationship — on the same terms as before the end of the Relationship — except as otherwise stated in this Clause.

*Commentary*

The idea is for a reseller, independent sales rep, etc., to close out any pending transactions. (This might presuppose a "friendly" termination of the relationship.)

### 22.153.5 List of wrap-up transactions

IF: A party wishes to take advantage of the Wrap-Up Period; THEN: Not later than two business days after the date that the Relationship ends, that party must furnish the other party with a complete written list of pending transactions expected to be completed during the Wrap-Up Period.

*Commentary*

This requirement helps the other party to confirm that the Wrap-Up Period isn't being used to develop new business.

### 22.153.6 Confirmation of wrap-up eligibility

IF: A party asserts the right to complete a particular transaction during a Wrap-Up Period; THEN: The other party may ask the asserting party to furnish evidence, reasonably satisfactory to the other party, that the asserting party had in fact been actively engaged in negotiating that transaction before the end of the Relationship.

*Commentary*

This provision is another mechanism to help keep a terminated party from surreptitiously starting new business after termination.

## Clause 22.154 Third-Party Beneficiary Disclaimer

The parties do not intend for the Contract to create any right or benefit for any party except themselves, *except* to the extent — if any — that the Contract clearly states otherwise.

*Commentary*

See generally, e.g., Third-Party Beneficiary (Wikipedia.org).

A 2016 lawsuit is fairly typical of the genre: In an opinion by Judge Posner, the Seventh Circuit affirmed a summary judgment in favor of an additive manufacturer that was sued by a distributor's end-customer:

> Although as the ultimate consumer ACL could expect to benefit from Lubrizol's sale of the additive to its distributor, *that expectation* did not make ACL a third–party beneficiary of the contract between VCS and Lubrizol. *More was required*. Otherwise a consumer would be a third–party beneficiary of any sales contract between a supplier of a good and a distributor of the good to the consumer.

See Am. Comm'l Lines, LLC v. Lubrizol Corp., 817 F.3d 548, 551 (7th Cir. 2016) (affirming summary judgment) (emphasis added.)

**Caution:** Inconsistency about intended third-party beneficiaries can lead to extensive litigation — in the aftermath of the sale of eight hospitals, the Delaware chancery court denied the buyer's motion to dismiss an indemnity claim by an affiliate of the seller, on grounds that the contract in question was ambiguous whether the contract's indemnity provision was negated by a disclaimer of third-party beneficiaries.

See CHS/Community Health Sys., Inc. v. Steward Health Care Sys. LLC, No. 2019-0165 (Del. Ch. Aug. 21, 2020). (Hat tip: Glenn D. West.)

## Clause 22.155 Time of Day Definition

A time of day refers to the exact time (in the relevant time zone if not otherwise specified).

Hypothetical example: The term "The deadline for submitting a bid is 5 p.m." means that a bid will be untimely unless submitted before exactly 5:00:00.00 p.m.

*Commentary*

Why bother defining *time of day*? Because the issue has come up in two Canadian cases where this issue arose in the context of disputes whether contract bids had been timely submitted; the two courts reached opposite results:

(1) In one case, a company's bid for a construction contract was time-stamped as having been submitted at 11:01 a.m.; the deadline was 11:00 a.m. Technical analysis indicated that the time clock was fast, and that the actual time of the bid submission was sometime between 11:00 a.m. and 11:01 a.m.. The British Colombia supreme court held that the bid was untimely.

See Smith Bros. & Wilson (B.C.) Ltd. v. B.C. Hydro, 30 BCLR (3d) 334, 33 CLR (2d) 64 (1997):

(2) In contrast, in another case the contract bids were due no later than 1 p.m. The winning bid was submitted at 1 p.m. *and 30 seconds*. The Ontario court of appeals held that the bid was timely submitted because the clock had not yet reached 1:01 p.m.

See Bradscot (MCL) Ltd. v. Hamilton-Wentworth Catholic District School Board, 42 O.R. (3d) 723, [1999] O.J. No. 69.

## Clause 22.156 Timely Definition

An action is timely (or "seasonable") if the action is taken at or within the time agreed or, if no time is agreed, at or within a reasonable time.

*Commentary*

"Timely" is a useful but vague term, so this definition borrows from the definition of of *seasonably* in UCC 1-205. (Many modern readers seem not to be familiar with the term *seasonably*.)

## Clause 22.157 Trademark Use

### 22.157.1 Applicability; parties

This Clause applies if and when, under the Contract, a specified party ("*User*") is authorized to use one or more specified trademarks, service marks, trade names, designs, and/or trade dress ("*Marks*") of another party ("*Owner*"); this authorization is referred to as the "*Trademark License*."

*Commentary*

This Clause draws on ideas found in the trademark license agreement form of The University of Texas at Austin, at https://tinyurl.com/UTTrademarkLicense. For many years "The University," as it's known in Texas, has been one of the most successful collegiate brand merchandisers; for example: "Texas football took in $32 million in royalties, licensing and sponsorships during the 2017-18 athletic year, according to the most recent audited data."

> Brian Davis, Texas athletics signs new 12-year, $96 million deal with Collegiate Licensing Company (HookEm.com Dec. 9, 2019) (a site maintained by the *Austin American-Statesman* newspaper). UT Austin is the present author's alma mater; I surmise (but intentionally haven't tried to confirm) that the principal author(s) of the license agreement were some of my former colleagues at Arnold, White & Durkee.

### 22.157.2 Business details worksheet

Unless the Contract clearly specifies otherwise, the following terms apply:

1. Licensed Marks?

   Only those specifically listed or described in the Contract.

2. Territory of Trademark License?

   ☒ The city in which User's initial address for notice is located.

   ☐ Other: *[Describe in detail in the Contract]*.

3. Trademark License Term?

   ☒ The term of the Contract.

   ☐ Other: *[Describe in detail in the Contract]*.

4. Licensed Items?

   Only those goods and/or services specifed in the Contract.

5. Has Owner promulgated detailed specifications for Licensed Items?

   ☒ No.

   ☐ Other: *[Describe in detail in the Contract]*.

6. Has Owner promulgated detailed usage requirements for Licensed Marks?

☒ No.

☐ Other: *[Describe in detail in the Contract]*.

7. Exclusivity of Trademark License?

☒ None.

☐ Other: *[Describe in detail in the Contract]*. *(See also [PH].)*

8. Is Owner approval of specific proposed uses required?

☒ No.

☐ Other: *[Describe in detail in the Contract]*. (See § 22.157.11.)

9. Will approval of specific uses be deemed granted after X days (absent objection)?

☒ No.

☐ Yes, after ten business days, per § 22.157.11.

10. Are sublicenses authorized?

☒ No.

☐ Other: *[Describe in detail in the Contract]*.

### 22.157.3 Grant of Trademark License

a. When Owner and User enter into the Contract, Owner, by doing so, grants User the Trademark License.

b. The Contract does not grant User any other right, title, or interest in any Licensed Mark unless the Contract expressly says so.

### 22.157.4 Specifications for Licensed Item(s)

If the Contract sets out (or references) specifications for Licensed Items, then all Licensed Items must conform to those specifications.

### 22.157.5 Permitted style(s) for use of Licensed Mark(s)

User must comply with any specific style requirements for use of the Licensed Mark(s) set forth in the Contract —

for example, color schemes, fonts, etc. —

or if none, then User must use the Licensed Mark(s) only in styles conforming to both:

(i) Owner's then-current use of the Licensed Mark(s), and

(ii) generally-accepted good commercial practice.

### 22.157.6 Required marking of Licensed Marks

Whenever displaying or otherwise using any Licensed Mark, User must include any notice or marking required by applicable trademark law or otherwise specified by Owner,

for example, the "®" (r-in-a-circle) symbol for registered marks

or the "TM" or "SM" symbol for unregistered trademarks and service marks, respectively.

*Commentary*

Concerning the "®" (r-in-a-circle) symbol, see generally 15 U.S.C. § 1111.

### 22.157.7 Usage specimens

IF: Owner so requests in writing from time to time; THEN: User must provide Owner, at no charge, with representative specimens of:

1. Licensed Items, and

2. any and all other uses of Licensed Marks by User such as (without limitation) advertisements.

*Commentary*

Subdivision 2 is meant to give Owner the right to monitor *all* uses of Licensed Marks by User, especially those that might not be authorized.

### 22.157.8 Owner inspections of User's usage

a. Owner may, from time to time, inspect User's use and/or display of the Licensed Marks to check for compliance with this Clause.

b. Tango Clause 22.84 - Inspections Protocol will apply to any such inspections.

*Commentary*

**Pro tip:** In some situations, Owner might also want the right to inspect User's facilities for making products that will bear Licensed Marks, for quality-control purposes.

### 22.157.9 If Owner modifies a Licensed Mark

Owner may, from time to time, modify any Licensed Mark; IF: Owner does so and advises User in writing of the modification; THEN: User must begin using the modified Licensed Mark in lieu of the previous form as soon as practicable afterwards.

### 22.157.10 Option: No Other Marks Allowed

IF: This Option is agreed to; THEN: User may not use any Mark on Licensed Items other than specifically-authorized Licensed Mark(s), *except*: (i) User's own legal name; and/or (ii) User's genuine trade name.

### 22.157.11 Option: Owner Approval Requirement

a This section applies only if and to the extent so stated in the Contract (if any; see [NONE]).

a. ☐ User must not use any Licensed Mark, in advertising materials or otherwise, without Owner's specific approval of the proposed use.

b. ☐ Owner will be deemed to have approved a proposed specific use of a Licensed Mark if Owner has not advised User, in writing, of Owner's disapproval on or before the end of the time period specified in the Contract.

*Commentary*

For a detailed approval requirement, see page 2 of The University of Texas System's trademark license form at https://tinyurl.com/UTTrademarkLicense, which states:

> Licensee must obtain prior approval from Trademark Director for the use of Marks
>
> (i) on any products,

> (ii) for any services,
>
> (iii) in any form of advertising or other promotion, and
>
> (iv) in any advertising or promotional copy or graphics to be used by Licensee in any media,
>
> including a public address announcement or other audio or video broadcast.
>
> Trademark Director's approval will not be unreasonably withheld, conditioned or delayed;
>
> provided, however *[DCT comment: Ugh …]*, Trademark Director will have the right, in his or her sole discretion, to decline to approve any use of Marks on any products, for any service, or in copy or graphics that
>
> (i) violates any applicable Law, any applicable Athletic Organization Rules, or University Rules; or
>
> (ii) Trademark Director or other designated University Representative considers to be misleading or offensive.

(Extra paragraphing added.)

And at page 4:

> In accordance with Section 3.2, Licensee will send to Board for its prior written approval the text and layout of all proposed advertisements and marketing and promotional material relating to or using the Marks,
>
> which approval may be given or withheld in Board's sole discretion.
>
> In the event that Board disapproves, Board will give written notice of its disapproval to Licensee within 14 days after receipt by Board of the material.
>
> In the absence of a written notice of disapproval within 14 days after receipt of the materials, the materials will be deemed to have been disapproved by Board.
>
> Licensee will not use any Mark in any advertising, marketing or promotion if the use has not been approved by Board.

(Extra paragraphing added.)

### 22.157.12 Third-party challenges to Licensed Marks

Tango Clause 22.87 - Intellectual Property Rights Challenges will govern any situation in which a third party:

1. might be infringing a Licensed Mark; and/or
2. challenges the validity or enforceability of Owner's rights in any Licensed Mark.

### 22.157.13 No Owner warranties about the Licensed Marks

Unless the Contract unambiguously says otherwise: Owner DISCLAIMS any representation, warranty, condition, or term of quality, to the effect:—

1. that any Licensed Mark is legally protectable against use by others; or

2. that User's use of the Licensed Mark(s) under the Contract will not infringe the rights of one or more third parties.

### 22.157.14 User responsibility for its business liabilities

User must defend (as defined in Clause 22.46) Owner's Protected Group (as defined in Clause 22.126) against any third-party claim arising out of or relating to:

1. User's business, including but not limited to any third-party claim of (i) product liability for Licensed Items and (ii) infringement of third-party intellectual property rights by Licensed Items; and/or

2. any breach of the Contract by User.

### 22.157.15 Inurement to Owner of User's use

Any use of a Licensed Mark by User will count as establishing ownership of that Licensed Mark by Owner, not by User.

*(In legalese: All use of any Licensed Mark by User will inure exclusively to the benefit of Owner.)*

*Commentary*

This section derives from some technical aspects of trademark law that are beyond the scope of this discussion.

### 22.157.16 In-Territory registrations

If (and only if) Owner so requests in writing, User will take any steps that Owner reasonably considers necessary to do one or more of the following:

1. register any Licensed Mark in the Territory (at Owner's expense);

2. maintain or renew any registration of a Licensed Mark in the Territory (at Owner's expense); and/or

3. prepare and file any registered-user registration required by applicable law for User's use of Licensed Mark(s) in the Territory (at User's expense).

*Commentary*

See generally:

- World Intellectual Property Organization, Introduction to trademark law and practice § 9.5 (2d ed. 1993)
- the sample registered-user language at LawInsider, https://www.lawinsider.-com/clause/registration-registered-user-agreements

### 22.157.17 User assignment to Owner

a. This section applies in any jurisdiction where, by law, User acquires or otherwise owns any rights or other interest in a Licensed Mark.

b. User hereby assigns all such rights to Owner,

together with all associated goodwill, registrations, applications for registration, and rights to sue for infringement — if any —

without any further action by either User or Owner.

c. User will comply with the ownership-transfer and -confirmation provisions of Tango Clause 22.86 - Intellectual Property Ownership.

*Commentary*

For the reasoning behind using the term "hereby assigns," see [NONE] and its commentary.

### 22.157.18 Prohibited User actions concerning the Licensed Marks

a. Without limiting User's other obligations under this Clause, User must not, anywhere, without Owner's discretionary consent (see the definition in Clause 22.49), do any of the following:

a. assert that User owns any right in any Licensed Mark not expressly stated in the Contract;

b. challenge Owner's rights in any Licensed Mark;

c. challenge the legal protectability of any Licensed Mark;

d. challenge the validity of any registration or application for registration, owned or approved by Owner, for any Licensed Mark;

e. use any Licensed Mark, or any confusingly similar variation, in User's corporate name or trade name;

f. apply for registration or recordation of (i) any Licensed Mark, or (ii) the Trademark License;

g. apply for registration of any Mark confusingly similar to any Licensed Mark;

h. attempt to register any Web address (URL) that:

(i) contains any Licensed Mark or any distinguishing feature of a Licensed Mark, or

(ii) is confusingly similar to any Licensed Mark;

i. purport to grant,

or to record or otherwise perfect,

a security interest (or comparable lien-type interest) in,

or to otherwise encumber,

(i) any Licensed Mark;

(ii) the Trademark License; or

(iii) any registration or application for registration, anywhere, relating to any Licensed Mark;

j. take any action that could invalidate or jeopardize any registration or application for registration of any Licensed Mark; or

k. assign the Trademark License.

b. Owner may terminate the Trademark License — without opportunity to cure — if User takes any of the actions prohibited by subdivision a; any such termination (i) will be in Owner's sole discretion (see the definition in Clause 22.49), and (ii) will be effective immediately upon notice (see Tango Clause 22.112 - Notices).

*Commentary*

It should be no surprise that, if User were to take any steps that could jeopardize Owner's rights in the Licensed Mark, Owner would want to immediately "fire" User by terminating User's right to use those marks.

### 22.157.19 Required User steps to to protect Owner's goodwill

User must not do any of the things prohibited in this section without Owner's express prior written discretionary consent (see the definition in Clause 22.49):

a. *No misleading or offensive use:* User must not use any Licensed Mark in any manner that:—

1. is misleading or otherwise deceptive;

2. would, in Owner's sole judgment, be offensive to a relevant segment of the population; and/or

3. could otherwise diminish the reputation of Owner, its Marks, or its goods and/or services;

b. *No use for substandard Licensed Items:* User must not use any Licensed Mark on, or in promoting, Licensed Items that do not meet standards stated or referred to in the Contract.

c. *Immediate cessation:* User must stop any particular use of a Licensed Mark immediately upon notice (see the definition in Clause 22.112) from Owner that Owner objects to that particular use.

d. *Respect for Territory boundaries:* User must not:

1. use any Licensed Mark, or any confusingly similar variation, in advertising or promotion outside the Territory;

2. use any Licensed Mark in actively promoting Licensed Items outside the Territory;

3. establish or maintain facilities specifically for supporting customers' use of Licensed Items bearing any Licensed Mark if such use is reasonably likely to occur outside the Territory; or

4. establish or maintain facilities outside the Territory for distributing Licensed Items bearing any Licensed Mark.

e. *No jeopardizing economic value:* User must not:

1. use a Licensed Mark to mark and promote any goods or services other than Licensed Items;

2. modify any Licensed Mark;

3. include any Licensed Mark,

or any distinguishing feature of a Licensed Mark,

as a feature or design element of another Mark; nor

4. use any Licensed Mark in any manner except as authorized by the Contract.

f. *No aiding or abetting others:* User must not permit, encourage, or knowingly help, any other individual or organization to take any of the actions prohibited by this section.

### 22.157.20 Actions for improper use

IF: At any time, by notice (see the definition in Clause 22.112) to User, Owner objects to one or more particular uses of a Licensed Mark by User as violating any of the prohibitions of [NONE];

THEN: User must, at its own expense, take the actions stated in subdivision c of [NONE] (delivery or destruction of tangible items).

### 22.157.21 Required post-termination actions by User

This section applies if the Trademark License expires or is otherwise terminated in any manner.

a. *Cessation of all use of Licensed Marks:* User must immediately stop all use of the Licensed Mark(s) — other than use that would not violate applicable trademark law in the absence of a license, for example, so-called nominative use.

b. *Transfer of all related Web address(es) to Owner:* User must immediately transfer to Owner the ownership of any Web address, i.e., of any Internet domain name that (i) that contains any Licensed Mark or any variation thereof, and/or (ii) is confusingly similar to any Licensed Mark. NOTE: This subdivision does not authorize User to register any such Web address.

c. *Delivery of tangible Licensed Items:* IF: Owner so requests in writing; THEN: User, at its own expense, must promptly: (i) do one or more of the following, as selected by User, and (ii) certify completion in writing to Owner:

1. deliver to Owner all tangible Licensed Items bearing any Licensed Mark;

2. permanently remove all Licensed Mark(s) from such Licensed Items; and/or

3. destroy all Licensed Items bearing any Licensed Mark.

*Commentary*

Subdivision b might be the term with the most-immediate impact; it's akin to requiring, say, a restaurant operating under a national franchise to transfer the restaurant's phone number if the franchise is terminated or expires.

### 22.157.22 Injunctive relief

Owner may seek preliminary- and/or permanent injunctive relief against User for violation of this Clause.

*Commentary*

See also Tango Clause 22.56 - Equitable Relief and Tango Clause 22.24 - Bond Waiver.

## Clause 22.158 Training General-Provisions

### 22.158.1 Applicability; parties

This Clause applies if and when a party, referred to as "*Provider*," will provide training to personnel of another party, referred to as "*Customer*."

*Commentary*

When a contract requires a party to provide training, it should set forth specific details about the training, such as the following (as appropriate):

a. contact information for lead representatives for each party;

b. specific courses to be offered;

c. physical location(s) of training, if any;

d. minimum- and maximum class size;

e. scheduling;

f. required trainee qualifications (prerequisites);

g. logistical support to be provided by the party whose people are being trained;

h. registration deadline;

i. cancellation- and refund policy;

j. any fee(s) that the training provider will charge,including but not limited to:

- any minimum fee (and how many attenders does that cover);
- any per-person fee;
- materials charges, if any;

k. reimbursement of the training provider's expenses — see [NONE];

l. payment deadline(s) — see [NONE].

### 22.158.2 Trainees' expenses

As between Customer and Provider, Customer is responsible for:

1. all salary and benefits of Customer personnel attending training; and

2. all expenses of those personnel in connection with attending training, including without limitation:

expenses for travel, lodging, and meals, if any; and

expenses for video conferencing and other Internet access, if applicable.

### 22.158.3 Rules for trainees and other visitors

Provider and Customer must each comply with the following:

• When accessing the other party's computers or network: [NONE]

• When on-site at the other party's physical premises: [NONE]

### 22.158.4 Trainee- or instructor misconduct

Each party must:

1. indemnify (see the definition in Clause 22.78) the other party's Protected Group (see the definition in Clause 22.126) against any foreseeable loss or expense, and

2. defend (as defined in Clause 22.46) the other party's Protected Group (as defined in Clause 22.126) against any claim (see the definition in Clause 22.29),

where the loss, expense, or claim arises from negligence or other alleged misconduct, by the first party's personnel, in the course of such training.

## Clause 22.159 Tribunal Definition

The term *tribunal* refers to a panel of one or more neutral officials,

including but not limited to courts; arbitration tribunals; administrative agencies; and legislative bodies,

where:

1. one or more parties presents evidence or legal argument or both to the panel; and

2. thereafter, the panel renders a binding legal judgment that directly affects the interests of one or more parties in the matter in question.

*Commentary*

This definition of *tribunal* is adapted from proposed amendments to Rule 1.00(u) of the 2010 proposed amendments to the Texas Disciplinary Rules of Professional Conduct [for lawyers]. (The proposed amendments were rejected in a referendum for unrelated reasons.)

## Clause 22.160 Usury Savings

a. Any charging or acceptance of unlawful interest is to be regarded as a mistake and promptly refunded upon request.

b. This Clause does not in itself authorize the charging of interest on past-due amounts.

Commentary

### 22.160.1 Business context

Even *invoicing* for unlawfully-excessive interest, or charging interest too early, can trigger civil- and even criminal usury penalties. And in some jurisdictions, if a party charges interest that violates applicable law, the party could end up *forfeiting its claim to the entire amount owed*, not just to that portion of the interest that exceeds the maximum amount.

See generally Ross Spence, Usury and How to Avoid It: Impact of New Legislation on Collection Practices at part VI-B, pp.24-25, (SnowSpenceLaw.com; undated), which includes extensive citations to Texas case law.

### 22.160.2 A usury savings clause *might* work

Usury "savings clauses," along the general lines of this Clause, are often included in promissory notes and other contracts that allow for charging interest. **But:** Usury savings clauses might — or might not — be effective in a given jurisdiction. For example:

• Texas law permits usury-savings clauses.

> See generally Spence, supra, at 34.

• In contrast, *Rhode Island's* supreme court acknowledged that the state's usury statute was "draconian" and "strong medicine"; the court said that the legislature had put the risk of charging too high an interest rate onto the lender in "an inflexible, hardline approach to usury that is tantamount to strict liability …." The court affirmed a trial-court ruling that a commercial loan agreement for more than $400,000 was void as usurious.

> LaBonte v. New England Development R.I., LLC, 93 A.3d 537, 544 (R.I. 2014).

### 22.160.3 What exactly *is* "usury"?

Not all charges that someone tries to characterize as "interest" will be subject to usury laws — especially if the charge reflects work done or service rendered. Here are a few examples from Texas:

• A bank's service fee for a bounced check (an "NSF charge") was held not to constitute usury.

> See First Bank v. Tony's Tortilla Factory, Inc., 877 S.W.2d 285, 285 (Tex. 1994).

• A cable-TV provider's administrative fee, charged for late bill payment, was held not to constitute usury.

> See Garcia v. Texas Cable Partners, L.P., 114 S.W.3d 561 (Tex. App.—Corpus Christi 2003) (affirming summary judgment in favor of cable company) (citing cases); see also, e.g., Gomez v. Niemann & Heyer, L.L.P., No. 1:16-CV-119-RP (W.D. Tex. Oct. 7, 2016) (denying motion to dismiss claims against debt-collector law firm; citing *Garcia*) (see also earlier order explaining background).

• Offering a lower price for cash payment is not usury, because in Texas, by statute, the term *interest* "does not include time price differential, regardless of how it is denominated. …"

> Tex. Fin. Code § 301.002(4) (emphasis added); see Spence, *supra,* at 9.

But what *is* this "time price differential"? One article explains the term in relation to Texas law:

> If certain requirements are met and a transaction is not designed to circumvent the usury laws, a merchant may sell merchandise at a higher price for credit than for cash and the price difference is not usurious. The new statute codifies the common law time-price doctrine.
>
> In order to apply the time-price doctrine, it must be shown that the seller clearly offered to sell goods for both a cash price and a credit or time price, that the purchaser was aware of the two offers, and that the purchaser knowingly chose the higher time or credit price.
>
> If an agreement fails to qualify as a time-price differential contract, then the finance charges may be found to constitute usurious interest.

> Spence, *supra*, at part VI-F, p.27 (citations omitted, extra paragraphing added).

### 22.160.4 Further reading

*(Optional for students.)*

See generally, e.g.:

- Bruce J. Bergman, Usury: Mortgage Void And Savings Clause Doesn't Work (BHPP.com 2015)

- Blank Rome, Can a Usury Savings Clause Save the Lender? (Martin-dale.com 2011)

For more-elaborate usury savings language, see generally the usury savings clauses shown at LawInsider.com.

## Clause 22.161 Voting Power Definition

a. Defining by example: Consider a corporation, having:

  a. articles of incorporation; and

  b. a board of directors whose members are elected by holders of voting shares.

b. For that corporation, 50% of the "*Voting Power*" of the corporation refers to one or more of the following legally-enforceable rights (see subdivision c):

  a. the right to vote at least 50% of such voting shares; and/or

  b. the right to select at least 50% of the members of the board of directors.

c. The rights referred to in subdivision c can arise:

  a. by ownership of shares;

  b. by contract, for example, a voting trust or voting agreement; and/or

  c. by a provision in the articles of incorporation.

d. This Definition will apply in similar fashion to organizations of any other type (including without limitation not-for-profit organizations).

*Commentary*

Concerning voting agreements, see generally, e.g.,

- The Delaware statute concerning voting trusts and voting agreements, 8 Del. Code § 218; and
- The 1996 voting agreement between Jeff Bezos and the Series A investors in Amazon.com.

## Clause 22.162 Waivers

### 22.162.1 Requirements for waivers

a. Neither party will assert a waiver, by another party, of any provision of the Contract, nor of any related document, *unless* the waiver is:

1. in writing;
2. clearly recognizable as a waiver; and
3. signed by the other party (or, if the other party is an organization, by an authorized representative of the other party).

b. An individual signing a waiver on behalf of an organization must have at least apparent authority to do so.

*Commentary*

This writing requirement tries to reconcile:

1. the legitimate concern that an unscrupulous party might try to get another party's personnel to sign a form (a purchase order, an order confirmation, etc.) that would have the effect of waiving a right or obligation;
2. the concern that a party might claim that a "stray remark" in an email, etc., had the effect of being a waiver; and

3. the need for parties to have at least some flexibility in their dealings, without being unduly hamstrung by what might be a long-forgotten contract.

Subdivision a.2 – labeled with reasonable prominence: This is to reduce the chances that parties will dispute whether a particular communication constituted a waiver.

Subdivision b – apparent authority: As one example, in a Tenth Circuit case, a company was held to be bound by a contract that had been signed by an executive vice president, even though that individual did not have *internal* authority within the company to do so.

See Digital Ally, Inc., v. Z3 Tech., LLC, 754 F.3d 802, 812-14 (10th Cir. 2014); see generally https://en.wikipedia.org/wiki/Apparent_authority.

Alternative:

> No waiver will be binding on a party that is an organization unless signed on behalf of the organization by an individual at the vice-president level or higher (or in a comparable position in an organization not having a vice-president).

This alternative would help to preclude a party from claiming to have relied on the "apparent authority" of other would-be signers.

Under a New York statute, a waiver of a statute of limitations defense must be in writing.

See Sotheby's, Inc. v. Mao, 2019 N.Y. Slip Op 03477, 173 A.D.3d 72, 100 N.Y.S.3d 27, (N.Y. App. Div. 2019) (affirming dismissal of Sotheby's complaint), *citing* N.Y. Gen. Oblig. Law § 17-103.

### 22.162.2 Knowing and intentional

a. This section applies if a party waives: (i) a right under the Contract, and/or (ii) another party's performance of an obligation under the Contract.

b. The waiver is to be deemed as having been made knowingly; voluntarily; intentionally; permanently; and irrevocably, *unless* the waiver unambiguously says otherwise /in writing — this will be true even if the waiver is (and is allowed to be) non-written.

### 22.162.3 Limited effect

a. A waiver will affect only the specific provision(s) of the Contract Document

that are clearly identified in the waiver document;

all other terms of the document will remain in effect as before the amendment or waiver.

b. A waiver is effective only for the specific provision or breach being waived,

on a one-time basis only.

*Commentary*

Limited-effect language along these lines is often seen in waiver provisions; this section makes that automatic.

See generally, e.g., Title Guaranty Escrow Services, Inc., v. Wailea Resort Co., 456 P.3d 107, 109 (Haw. 2019), where an amendment to the contract in suit contained similar language (which was not relevant to the lawsuit).

### 22.162.4 Governing law for waiver assertions

a. New York's General Obligations Law 15-301(1) is to control in any dispute arising out of or relating to this Clause, regardless of what law would otherwise govern the Contract — in that statutory provision, the parties intend for the term "change" to be interpreted as encompassing waivers.

b. The parties are agreeing to this provision-specific choice of law:

1. in the interest of uniformity; and

2. to reduce uncertainty about how a court or other tribunal might interpret this Clause.

*Commentary*

New York's General Obligations Law 15-301(1) provides that "[a] written agreement … which contains a provision to the effect that it cannot be changed orally, cannot be changed by an executory agreement unless such executory agreement is in writing and signed by the party against whom enforcement of the change is sought or by his agent."

Concerning having a provision-specific governing law, see Section 22.70.14: .

And for a discussion of laws and court cases where *oral* amendments and waivers have been asserted, see the commentary at Section 22.4.3: .

### 22.162.5 Standard of proof for assertions of *oral* waiver

a. As a fallback rule, this section applies if:

a. a party asserts that a provision in the Contract was *orally* waived; and

b. a court or other tribunal of competent jurisdiction holds that the applicable law allows oral modification despite the parties' agreement to this Clause.

b. In such a case, the asserting party **WAIVES** its assertion of that oral modification if the asserting party does not do the following:

a. The asserting party must show, by clear and convincing evidence (see the definition in Clause 22.30), that the other party agreed to each such alleged oral waiver; and

b. If asked, the asserting party must promptly produce all related (unprivileged) evidence in the asserting party's possession, custody, or control in accordance with the initial-disclosure and discovery procedures of the (U.S.) Federal Rules of Civil Procedure.

*Commentary*

See the commentary to Tango Clause 22.4 - Amendments.

## Clause 22.163 Warranty Definition

### 22.163.1 Definition: *Warrant*; *warranty*

The noun *warranty* and the verb *warrant* refer to:

a statement of past, present, or future fact, by a party ("*warranting party*"),

namely that a specified state of affairs exists, or existed, or will exist,

at or during a specified time — which is deemed to be the time at which the warranting party formally assents to the document containing the warranty unless unambiguously stated otherwise in writing.

*Commentary*

Like a representation (see the definition in Clause 22.134), a warranty is a particular type of statement that, if false, can lead to liability — but the resemblance largely ends there, because a warranty has a different legal effect than a mere representation (as explained in more detail in [BROKEN LINK: reps-warr-bkg][BROKEN LINK: reps-warr-bkg][BROKEN LINK: reps-warr-bkg]).

### 22.163.2 Legal effect of a warranty

A warranty is to be considered a conditional promise — in legalese, a conditional covenant — made by the warranting party, for the benefit of the beneficiary or beneficiaries (see [NONE]),

that IF the warranted statement proves untrue, THEN, *regardless* whether the warranting party was or was not at fault for the untruth:

1. the warranting party will take one or more actions clearly specified in the Contract, if any; or

2. if the Contract does not specify any such actions, then the warranting party will reimburse the warranty beneficiary (or -beneficiaries) for the *foreseeable*, *ordinary-course*, *economic* losses that are incurred by the warranty beneficiary as a result of the untruth of the warranted statement.

*Commentary*

It will be apparent that a plaintiff must check fewer boxes to prove breach of warranty than to prove misrepresentation — but as discussed at § 13.3.1, successful proof of breach of *warranty* results in fewer "rewards" in the form of remedies that can be had in court or in arbitration.

Subdivision 2: The "foreseeable, ordinary-course economic losses" language draws on the well-known English case of *Hadley v. Baxendale*, discussed in the commentary to the definition of *consequential damages* at [NONE].

### 22.163.3 Warranties and limitations of liability

A warranting party's obligations under a warranty will be subject to any applicable exclusions of remedies or other limitations of liability stated in the Contract.

*Commentary*

See generally [NONE] (and its commentary) and Section 17: concerning limitations of liability.

### 22.163.4 Limited warranty beneficiaries

a. IF: A warranty does not clearly identify its beneficiaries; THEN: The warranty will benefit only the other party (or if more than one, all other *relevant* parties) to the Contract.

b. If a warranty does clearly identify its beneficiaries, then the warranty will benefit only those specific individuals and organizations so identified.

*Commentary*

A party that wants its own affiliates, etc., to benefit from a warranty should make that clear in the warranty language itself. Here's a hypothetical example: "ABC warrants *to XYZ and XYZ's Affiliates* that …."

### 22.163.5 Presumption of beneficiary's reliance

Each beneficiary of a warranty (see § 22.163.4) is to be rebuttably presumed to have reasonably relied on that warranty as part of the basis of the bargain of the Contract.

*Commentary*

This section seeks to avoid a satellite issue that is *somewhat* settled in the law but might still give rise to disputes; see the discussion at Section 13.3.1: for additional discussion and citations.

# Clause 22.164 Warranty Disclaimer General Terms

## 22.164.1 No effect on *express* warranties, etc.

In case of doubt, a disclaimer of *implied* warranties does *not* affect any *express* warranties, representations, or other factual commitments that are clearly stated in the Contract.

*Commentary*

This section provides some reassurance to a contract *reviewer* that this disclaimer doesn't affect the *express* warranties, etc., in the Contract.

(The author has more than once — including just this past week, at this writing — encountered contract reviewers who were unsettled by the breadth of a disclaimer of *implied* warranties but had apparently overlooked the part about *express* warranties being unaffected.)

## 22.164.2 Implied conditions, terms of quality disclaimed too

A party that disclaims implied *warranties* also disclaims any purportedly-implied representations, *conditions*, *terms of quality*, and similar commitments.

*Commentary*

This section addresses an issue that has gotten companies into trouble under English law, as explained in § 13.4.5, namely the need to disclaim more than just implied *warranties*.

Incidentally: Disclaiming implied *representations* might be trickier, as discussed at § 13.5.2.

## 22.164.3 Broad scope of disclaimer

A disclaimer of implied warranties applies regardless whether any purported implied warranty (or implied condition, term of quality, etc.) is claimed to arise:

a. by law;

b. by an alleged custom, practice, or usage in the trade; and/or

c. by an alleged course of dealing or performance by the parties themselves.

*Commentary*

This section is intended as a roadblock to forestall "creative" contrary claims.

## Clause 22.165 Will Definition

Unless the context clearly and unmistakably requires otherwise, terms such as "Party A will take Action X" mean that Party A is *required* to take Action X; likewise, "Party B will not take Action Z" means that Party B is prohibited from taking Action Z.

*Commentary*

See the commentary to the definition of *shall* at [NONE], especially the present author's view that for some terms and conditions, *will* is softer and more business-like than *shall*.

**Caution:** Bad things could happen if a court were to read the term *will* in the "wrong" way. For example: In a 2014 opinion, the Supreme Court of Texas ruled in a Lubbock County case that the term *will*, in context, did not establish a contractual obligation, but merely stated the intent of one of the parties.

> See Lubbock County Water Control & Improvement Dist. v. Church & Akin, L.L.C., 442 S.W.3d 297, 306 n.10 (Tex. 2014) (reversing court of appeals and dismissing claim for want of jurisdiction).

Similar disputes might be avoided if the term *will* is defined as meaning *must*. In many cases that will (pardon the expression) be overkill, but it also might be one of those situations where a few extra words can sometimes be cheap insurance against a creative trial counsel. Conceivably, the result in the Lubbock County case might have been avoided by using *shall* instead of *will* in the contract language.

Professor Tina Stark (a friend of, and mentor to, the author) thinks that contract obligations should always be signaled by *shall*, not by *will*; I don't share that view.

> See generally Tina L. Stark, Drafting Contracts: How and Why Lawyers Do What They Do ch. 13 & 10.2.1 (2d ed. 2014). Of similar mind is Ken Adams, author of A Manual of Style for Con-

tract Drafting; a Google search will help the reader to find Ken's various on-line postings about *shall* versus *will*.

## Clause 22.166 Willful Definition

*Willful* and its variant spelling *wilful*, in the context of action or conduct (for example, *willful act* or *willful action* or *willful conduct* or *willful misconduct* or *willful neglect*), refer to action or conduct that would be tortious if engaged in outside the context of a contract.

*Commentary*

This definition is based on that of New York law. If the definition were ever to become relevant, it might well be in connection with a carve-out to a limitation of liability, as in a New York case in which that state's highest court looked to the doctrine of *ejusdem generis* in holding that, *in context*, the contractual term *willful acts* referred to *tortious* conduct, not merely to mere intentional nonperformance of the contract.

See, e.g., Metropolitan Life Ins. Co. v. Noble Lowndes Int'l, Inc., 84 N.Y.2d 430, 438, 643 N.E.2d 504, 618 N.Y.S.2d 882 (1994).

The meaning of *willful* also came under review in a U.S. Supreme Court's decision that arose because section 523(a)(6) of the Bankruptcy Code provides that debts from "willful and malicious injury" are not dischargeable in bankruptcy. The Court held that, *in context*, the term *willful* requires a showing of *intent to cause injury*, not merely of intent to take the action that resulted in the injury.

See Kawaauhau v. Geiger, 523 U.S. 57, 61-62 (1998).

Later, in the context of patent infringement, the Court held that the term *willful infringement* refers to "[t]he sort of conduct [that] has been variously described in our cases as willful, wanton, malicious, bad-faith, deliberate, consciously wrongful, flagrant, or—indeed—characteristic of a pirate."

Halo Elecs., Inc. v. Pulse Elecs., Inc., 136 S. Ct. 1923, 1932 (2016).

The better practice, of course, is not to rely on guesses about how a court will view the meaning of a term; this practice is summarized in the acronym W.I.D.D.: *When In Doubt, Define!*

### Clause 22.167 Writing (noun) Definition

*Writing* refers to a tangible or electronic record of a communication or representation; *written* has a corresponding meaning. The terms *writing* and *written* encompass, without limitation:

1. handwriting, typewriting, printing, photocopying, photography, audio or video recording, and e-mail; and

2. words, pictures, and diagrams.

*Commentary*

Portions of this definition are adapted from proposed amendments to Rule 1.00(v) of the 2010 proposed amendments to the Texas Disciplinary Rules of Professional Conduct [for lawyers]. (The proposed amendments were rejected in a referendum for unrelated reasons.)

## 22.168 About the author

I'm an AV-rated business lawyer and neutral arbitrator in Houston, as well as a part-time law professor teaching contract drafting. I'm licensed in Texas and California and am registered to practice in the U.S. Patent and Trademark Office. *(My last name is pronounced "Tate"; because of my Roman numeral my parents called me "D.C.," which stands for Dell Charles.)*

I'm a member of the bar in Texas and California, as well as registered to practice in the U.S. Patent and Trademark Office.

I'm an adjunct professor at the University of Houston Law Center, teaching contract drafting. I maintain a limited solo practice advising tech companies, both established and startups.

I was formerly a partner and member of the management committee at Arnold, White & Durkee, one of the largest IP-only law firms in the United States, with some 150 lawyers in six offices.

I left AW&D to become vice president and general counsel of BindView Corporation, a publicly-traded software company with some 500 employees in six

countries. As outside IP counsel, I'd helped the founders to start the company and later to go public; I served in-house until our successful "exit," when we were acquired by Symantec Corporation, the world leader in our field.

My law degree is from the University of Texas at Austin, where I was on law review; that's also where I received my undergraduate degree, in mathematics.

In between college and law school, I did my ROTC scholarship payback time as a U.S. Navy nuclear engineering officer (the Rickover program) and surface warfare officer, including three years of sea duty in the aircraft carrier USS ENTERPRISE. I was in charge of a 150-man engineering division; I also served as officer of the deck underway (in charge of the ship and its 5,000-man crew while on watch) and qualified as [chief] engineer officer of a naval nuclear powered ship.

My wife, Maretta Comfort Toedt, and I have two adult children and one son-in-law, all of whom live and work in Houston (and, says Maretta, don't call us enough).

Any views I might express here are my own, of course, and not necessarily those of clients, former employers, etc., etc.

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